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BILATERAL TRADE AGREEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

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CONTENTS

OPENING STATEMENTS

Page

Baucus, Hon. Max, a U.S. Senator from Montana (chairman of the subcommittee) 1
Danforth, Hon. John C., a U.S. Senator from Missouri 20

COMMITTEE PRESS RELEASE

Finance Subcommittee on Trade to Hold Hearings on Bilateral Trade Agreements and Oversight of the U.S.-Canada FTA 1

PUBLIC WITNESSES

Bergsten, C. Fred, director, Institute for International Economics, Washington, DC 3
Choate, Pat, vice president, office of policy analysis, TRW, Inc., Washington, DC 8
Morris, Robert J., senior vice president, U.S. Council for International Business, Washington, DC 10
Cooper, Doral S., president, C&W International, Ltd. 26
Aho, C. Michael, director of economic studies, Council on Foreign Relations, New York, NY 29
Erb, Guy F., director, U.S. Council of the Mexico-U.S. Business Committee, and managing director, Erb & Madian, Inc., Washington, DC 32

APPENDIX

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

Aho, C. Michael:
  Testimony 29
  Prepared statement 41
    Enclosure: "More Bilateral Trade Agreements Would be a Blunder: What the New President Should Do" 47
Baucus, Hon. Max:
  Opening statement 1
  Prepared statement 61
Bergsten, C. Fred:
  Testimony 3
  Prepared statement 62
Choate, Pat:
  Testimony 8
  Harvard Business Review article 68
Cooper, Doral S.:
  Testimony 26
  Prepared statement 76
Danforth, Hon. John C.:
  Opening statement 20
Erb, Guy F.:
  Testimony 32
  Prepared statement with attachments 79

Page

Morris, Robert J.:
  Testimony 10
  Prepared statement 90

COMMUNICATIONS

"Trading Bloc Heads," article from the International Economy, by Joseph A. Greenwald 93

BILATERAL TRADE AGREEMENTS

MONDAY, MARCH 13, 1989

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:38 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Also present: Senators Danforth and Chafee.

[The press release announcing the hearing follows:]

[Press Release No. H-8, February 7, 1989]

FINANCE SUBCOMMITTEE ON TRADE TO HOLD HEARINGS ON BILATERAL TRADE AGREEMENTS AND OVERSIGHT OF THE U.S.-CANADA FTA

WASHINGTON, DC—Senator Max Baucus (D., Montana), Chairman, announced today the Subcommittee on International Trade will hold a hearing to examine the possibility of future bilateral trade agreements. The hearing will examine the relationship between bilateral trade agreements and the General Agreement on Tariffs and Trade, and the potential for bilateral arrangements to address U.S. trade problems.

Senator Baucus said, "The U.S.-Canada Free Trade Agreement (FTA) demonstrates that we can conclude bilateral trade agreements with our most important trading partners. With the prospects for meaningful progress in the GATT Round uncertain, we must take a hard look at our alternatives."

The hearing is scheduled for Monday, March 13, 1989 at 9:30 a.m. in room SD-215 of the Dirksen Senate Office Building.

A second subcommittee hearing, to be held on Friday, April 7, 1989, at 9:30 a.m. in the same room, will examine ongoing trade disputes between the United States and Canada. These disputes include the memorandum of understanding on Softwood Lumber, the dispute over plywood standards, and the disputes over Canadian subsidies to natural resource based industries. The potential for the U.S.-Canada FTA to address these problems through dispute settlement procedures and ongoing negotiations will be discussed.

Senator Baucus said, "The U.S.-Canada FTA has ushered in a new era in U.S.-Canada trade relations. But many ongoing trade disputes must still be addressed."

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Today America faces, still, a severe international trade challenge. Our trade deficit remains at an unsustainable level of about $140 billion a year. And instead of getting better, it threatens to deteriorate in 1989.

The United States has had great difficulty gaining access to Japan, Korea, and other nations for U.S. exports. The Uruguay Round of GATT negotiations seems to be floundering over the difficult issues of agricultural subsidies and protection of intellectual property.

The prospect of a single European Market by 1992 raises the potential of further trade challenges in the near future. The only real bright spot in the current trade picture is the United States-Canadian Free Trade Agreement. The FTA reduced tariffs and liberalized trade between the United States and Canada. After some debate on both sides of the border, the agreement was ratified and took effect on January 1 of this year.

There is a lesson here, I think, for the present administration. The challenges we face are forcing broad and fundamental changes on the international trading environment. The administration, in consultation with Congress, must revise American trade policy in light of those broad changes. We certainly should not throw the baby out with the bath water.

Some parts of U.S. trade policy work, and work well. And with the passage of the 1988 Omnibus Trade Act, Congress has provided the administration with new tools that probably will prove useful.

But there is room for improvement. It is time for the U.S. Government to rethink its international trade strategy.

The system needs a shot in the arm. I believe that a new bilateral or plurilateral trading arrangement with the nations of the Pacific Rim, particularly Japan, may be just that shot in the arm that we need.

There are three new trade developments that we must consider as we forge our trade policy: the troubled Uruguay Round, the prospect of a single European market by 1992, and the implementation of the 1988 Omnibus Trade Act. Each of these developments strengthens the case for looking to the Pacific Rim.

The Uruguay Round of GATT is floundering badly after the breakdown of the mid-term negotiations in Montreal. I am optimistic that we can salvage the round during the April meeting of the GATT Ministers in Geneva, but we should revise our expectations. Even if the GATT round does begin moving in April, a final agreement is still some years away.

Further, the EC is dead set against eliminating agricultural subsidies, and Brazil and India will block efforts to protect intellectual property. This puts a limit on the progress that we can hope for in these areas.

We are unlikely to conclude a GATT agreement that meets all of our objectives in the foreseeable future. We need a second option.

Talks with the nations of the Pacific Rim serve as a warning to our trading partners against dragging their feet in the GATT Round. It also provides us with an insurance policy in case the GATT breaks down.

Further, bilateral or plurilateral talks provide a way to strengthen international trading rules in areas where the GATT is weak.

Finally, as the services title of the U.S.-Canada Free Trade Agreement demonstrated, bilateral and plurilateral talks can even point the way for future GATT agreements.

Bilateral and plurilateral talks are the perfect complement to the Uruguay Round, especially if the United States strives to conclude open, non-discriminatory trading arrangements with its Pacific Rim trading partners.

We must also keep an eye on EC-1992. We shouldn't overreact, but there is a real risk of Europe retreating into Fortress Europe as EC-92 proceeds.

We must let Brussels know in no uncertain terms that the United States will not take the prospect of Fortress Europe lying down. Perhaps the most effective way to do this is to initiate negotiations with the nations of the Pacific Rim.

The goal of these negotiations should not be developing a block that excludes Europe. But, if the nations of the Pacific Rim find themselves shut out of Europe, they will have a viable counter-threat. The threat of "Fortress Pacific" is the most effective counterbalance for Fortress Europe.

Finally, we should take full advantage of the new tools provided by the Omnibus Trade Act.

The Super 301 provision of the trade act makes a new round of trade negotiations with the nations of the Pacific Rim a certainty. The only question is the scope and setting for these negotiations.

I strongly advise the Bush administration to use Super 301 as an opportunity to make progress, not as another requirement to meet. Super 301 should be the springboard for launching a major trade and economic negotiation with Japan, with Korea, and with the other nations of the Pacific Rim. In the words of Mike Smith, former Deputy USTR: "The time is right to look to the Pacific Rim."

The times call for the Bush administration to develop an aggressive, pragmatic trade policy. We cannot afford to close our minds to new alternatives.

[The prepared statement of Senator Baucus appears in the appendix.]

Senator BAUCUS. I am pleased that we have here today an assembly of an excellent panel of witnesses to discuss these issues.

With that, let us begin with our panels. The first panel includes Fred Bergsten, who is the director of the Institute for International Economics; Dr. Pat Choate, who is the vice president of the office of policy analysis at TRW; and Mr. Robert Morris, senior vice president for the U.S. Council for International Business.

Fred, let us begin with you.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS, WASHINGTON, DC, ACCOMPANIED BY JEFFREY J. SCHOTT, RESEARCH FELLOW

Mr. BERGSTEN. Thank you very much, Mr. Chairman. It is a great pleasure to be here today.

I am accompanied by my colleague Jeffrey Schott, who has been working closely with me on these issues, and I want to split up our initial presentation.

But let me start with two points of background. The first is to underline the urgency and gravity of the problem that you have addressed with these hearings today. We at the Institute for International Economics have just completed a new analysis of the outlook for trade and current account balances for each of the major countries through 1992, and the results are shocking.

We conclude that, on the basis of present policies and present exchange rates, the U.S. current account deficit will, as you suggested, probably start rising again either this year or next, and by 1992 will be back up to about $150 billion.

Likewise, the Japanese surplus, which has been rising again for about the last 6 months, will continue to rise, and by 1992—on current policies and current exchange rates—will be something like $140 billion. The bilateral Japanese surplus with the United States will be something like $60-70 billion higher than it is today.

I think that outlook—which I stress is based on current policies and current exchange rates, meaning no further cuts in the U.S. budget deficit, and no new policies abroad—underlines the gravity of the problem and the urgency of taking new steps to deal with it.

The second point is to remind you, because you participated in it, that my institute sponsored a major conference on the issue of bilateral regional trading arrangements back in November. We looked in some depth at the possibilities for a wide array of bilateral and plurilateral arrangements and heard papers from each of the candidate countries on that prospect—Japan, Korea, Taiwan, ASEAN, Australia, Mexico, and the like.

What I would like to do today is turn first to my colleague Jeffrey Schott, who has written up the results of that conference and will be releasing his study in the next few weeks, and ask him to summarize the findings we reached on the issue of bilateral and regional trade agreements. Then I want to make some concluding comments on your own very creative proposal, Mr. Chairman, on the notion of a new, comprehensive U.S.-Japan bilateral accord.

Senator BAUCUS. Mr. Schott, go ahead.

Mr. SCHOTT. Thank you, Mr. Chairman.

The basic question that we addressed in our conference was, should the United States continue to pursue free trade agreements with other countries, or should it devote its efforts to multilateral negotiations in the Uruguay Round, in the GATT, and indeed can and should it do both?

The conclusion, as you noted, of free trade agreements with Israel and Canada raises the question whether the United States should concentrate more on free trade areas and on bilateral rather than multilateral agreements, and is based in part on concern that the GATT negotiations will not yield substantive results in a timely fashion, and that reduction of the U.S. trade deficit requires more aggressive U.S. trade policy measures.

Free trade agreements seem to produce results, although indeed they have had very little impact on the U.S. trade deficit. Thus, there has been quite a bit of discussion, as you noted, of more bilateral agreements with Japan and other countries in the Pacific Rim to achieve three traditional trade policy goals and one new goal: the reduction of foreign trade barriers, the promotion of multilateral accords in the Uruguay Round, the improvement of our bilateral trade relations with these countries, and a reduction in bilateral trade imbalances. This last is indeed a new trade policy goal.

Now, it is very easy to sell the GATT short, especially given the frustrations that inevitably arise at the midpoint of a trade negotiation. Critics have charged that the GATT is too slow, that its processes are too complex, both with regard to its agenda and with regard to the number of players involved, and that its rules are inadequate and inadequately enforced. But from my experience in the Tokyo Round as one of the U.S. negotiators of the GATT Subsidies Code, I would caution that the Committee not underestimate the potential of the Uruguay Round. Indeed, the Uruguay Round is ahead of the Tokyo Round in its pace of negotiations, given the results that were achieved, although incomplete, at the Montreal mid-term meeting.

If there is a breakthrough on the procedural bottlenecks in April, on the issues that weren't resolved in Montreal, I am confident that the negotiators can then proceed to the real hard-bargaining stage of the Round. This is comparable to the stage that was reached in fall of 1977 in the Tokyo Round, after the new team of trade negotiators got into place. And indeed, 18 months after that, the Tokyo Round was concluded. That is same period of time, 18 months, that it took to negotiate the U.S.-Canada agreement. So I don't think that the multilateral process is necessarily much slower than the bilateral process.

Is the multilateral process too complex? One needs to remember that the multilateral negotiations are really conducted among a critical mass of countries, not the full 96 members of the GATT. The agenda is no more complex than the agenda perceived for bilateral free trade area agreements, and it is less complicated than negotiating a series of free trade agreements. So, I think the complexity issue is also in part a red herring.

Finally, there is the need for a lot of players around the table to generate a pot of concessions big enough to justify concessions of our own. And to achieve the substantial and politically difficult reforms that we require of other countries, there needs to be a lot in that pot, so that everyone can get a share. That can only be achieved in a multilateral round. I think this point is particularly important now, when the United States needs an improvement of about $150 billion in its trade balance, to stop the future buildup of our foreign debt and our reliance on foreign financing.

It is difficult to conceive of any series of bilateral agreements that would open markets to our exports sufficiently to promote that goal. Therefore, a successful Uruguay Round is in fact crucial to contributing to the elimination of the U.S. trade deficit.

Now, as to the other goals, will bilateral agreements promote multilateral accords? It comes down to whether they can be building blocks on new issues such as services and intellectual property rights, or whether they are really defensive strategies that other countries pursue because they perceive the United States to be moving away from the Uruguay Round.

The reasons for foreign interest in bilateral negotiations most frequently cited during our conference were to avoid U.S. retaliation, to secure better access to the U.S. market through a reduction of current barriers or at least a standstill on future U.S. barriers, and to avoid discrimination should other countries negotiate free trade agreements with the United States.

These goals indicate that foreign countries do not see free trade agreements as a complement to the GATT process but rather as a substitute, given what they perceive may be the future course of U.S. trade policy.

The third point: Do these agreements improve bilateral relations? I think by their nature they do enhance trade relations between the United States and our partner countries. But what seem to be of interest to our foreign partners are the consultative and dispute-settlement mechanisms, such as those that were incorporated in the U.S.-Canada agreement.

Such provisions can be accomplished without a free trade agreement. Therefore, I don't think one has to resort to free trade area negotiations to improve bilateral relations. They can be achieved as a complement and parallel to negotiations in the Uruguay Round.

Fourth, the trade balancing objective. Here I think the real objective is to promote trade diversion, which is normally regarded as a major economic cost of free trade areas. I think Fred Bergsten will talk a little bit more on that specific point with regard to your own proposals, Mr. Chairman.

These four points have led us to conclude that free trade areas are an idea whose time has come—and probably passed. They have been useful to work out deals with Israel and Canada, and those agreements helped jumpstart the Uruguay Round, but now the maintenance of such a two-track approach, with bilateral talks serving as complements to the multilateral process, could indeed be counterproductive.

The United States cannot possibly achieve the liberalization of foreign trade barriers it needs by even the most extensive series of bilateral and regional agreements. In addition, U.S. efforts to reach new bilateral deals signal that the United States is moving away from the Uruguay Round and the GATT, and lead other countries to downplay or even forget about the multilateral process.

We therefore recommend that the United States publicly eschew any further pursuit of bilaterals until the outcome of the Uruguay Round is clear, and instead put all its energies into that effort.

Mr. BERGSTEN. Let me pick up from there, Mr. Chairman, and elaborate.

Senator BAUCUS. Before you begin. Fred, I forgot to indicate the time limit for each witness. I want to give each let's say 7 minutes. Let's say you have already used up—I would say, generously, four. So you have three more to go. [Laughter.]

Mr. BERGSTEN. Mr. Chairman, it is your choice. I want to address your proposal. I will do it in 3, 7, or 2. [Laughter.]

Senator BAUCUS. Okay. Why don't you do it in about 3, Fred.

Mr. BERGSTEN. I will be happy to do so.

I read your approach, Mr. Chairman, as going beyond the usual free trade area agreement, because it envisages including macroeconomic and monetary issues as well as trade, and therefore I want to address it in that broader context.

I think the structure of your proposal is absolutely right. Your proposal, as I understand it, suggests that the trade imbalances of the two countries must be addressed by changes in the macroeconomic policies of both, along with achievement and maintenance of an appropriate exchange rate between the yen and the dollar, that the disputes over trade barriers need to be handled through trade negotiations, and that international burden-sharing needs to be addressed comprehensively and systematically.

The real question is whether those objectives can be pursued more effectively in a bilateral or a multilateral framework, or by some mix of the two.

I think, on macroeconomic and monetary issues, it is fair to say that an informal G-2 between the United States and Japan already exists. I am skeptical, quite honestly, that formalizing that G-2 would enhance the prospects for better macroeconomic policies.

It has to be recognized that in the macro area Japan is already doing most of what the United States has asked for—they have let the yen rise from 260 to the dollar to 120 to the dollar, and they have indicated they are quite open to letting it rise to at least 100.

Japan's domestic demand growth over the last year has been 7 percent—the fastest in the world—and has led to a sharp rise in their imports. They must, of course, continue that progress over the next 4 or 5 years if we are to eliminate those big imbalances I talked about at the outset, but I doubt whether formalization on the macro and monetary side would have much effect.

The really critical issue, though, is how a formalization of the type you propose would relate the macro and monetary issues to the trade policy issues. I think, on the one hand, if there were a new framework, the Super 301 process and other bilateral negotiations would proceed in a less contentious atmosphere. On the other hand, I am very concerned—to elaborate on a point that Jeff Schott made—that if the United States were to include trade issues in its bilateral agreement with Japan, the result could be a substantial addition to the self-fulfilling prophecies of new trading blocs and a breakdown of the world trading system.

Mr. Chairman, I brought away one major conclusion from that conference last fall, and from my discussions around the world on trade issues, namely, that around the world there is a widespread perception that the global trading system is in the process right now of breaking up—with Europe 1992, the U.S.-Canada agreement heading toward a North American bloc, and perceived equivalents in Asia.

I happen to think that perception is incorrect. I do not see the world moving toward blocs at this time. But I think there is a perception around the world that it is moving that way. And if the United States were now to attempt to negotiate a major bilateral agreement with Japan—cutting across the ocean, cutting across the most important trading relationship in the world—I think the main result would be to feed that self-fulfilling prophecy, and countries around the world, far from being galvanized to support the multilateral approach, would in fact be at least as likely to move in the other direction.

You have suggested that one purpose would be to push the Europeans toward a successful Uruguay Round. I am afraid that the effect could be just the opposite—that those forces within Europe who want to be protective, who want to create a Fortress Europe out of the 1992 process, would be strengthened and would say, "The United States and Japan are going their way; they are entering into a bilateral agreement. We Europeans must defend ourselves." And I have heard that in country after country around the world.

My fear, therefore, is that an effort to deal with our trade problems with Japan in a bilateral context, even if it were based on the purest of motives with regard to the multilateral process, and even if it were linked to macroeconomic and monetary issues, would cut the other way.

Therefore, my conclusion on your proposal is the following: I think on balance you are correct in seeking to link together strategically the macro, trade, and burden-sharing issues. I think your proposal should be grasped by the administration as a fulcrum for generating a comprehensive U.S. strategy toward Japan. But I would not pursue that strategy through trying to work out a comprehensive bilateral accord. Rather, I would move separately but deliberately in each of the areas—macroeconomics through the financial officials, trade policy through the trade officials, burden-sharing through the foreign ministries—in a tightly coordinated and comprehensive way, but without, at this time, going for a new bilateral accord. I think that would achieve our purposes in each area, but would avoid the risks of undercutting the multilateral process and the Uruguay Round, whose outcomes are critically important to the United States for the reasons that Jeffrey Schott outlined.

Thank you very much.

Senator BAUCUS. Thank you very much.

[The prepared statements of Mr. Bergsten and Mr. Schott appear in the appendix.]

Senator BAUCUS. Dr. Choate, you are next.

STATEMENT OF DR. PAT CHOATE, VICE PRESIDENT, OFFICE OF POLICY ANALYSIS, TRW INC., WASHINGTON, DC

Dr. CHOATE. Thank you very much, Mr. Chairman.

The bilateral relationship is an extremely useful tool for the United States in the context of the 1988 Trade Act, a historical piece of legislation through which Congress has mandated that the U.S. Trade Representative annually come before Congress and identify a U.S. trade strategy. This morning, we must first consider the key principles in our trade strategy and in our trade tactics. In that context, there are some thoughts I would like to share.

First, I think we must start with the agreement that prudent macromeasures are essential. While this is a necessary condition it is—in and of itself—an insufficient one.

If we are to examine principles, me must identify how the U.S. economy is organized. Then, we must compare our own economic structure with those of our economic trading partners and our economic competitors, to see whether—given the differences—existing approaches, existing institutional arrangements and existing negotiating forms are sufficient to expand trade. Perhaps other supplemental actions like bilateral agreements are required.

We start off, for example, with very real differences in the structure and size of the industrial enterprises of the United States and Japan. The Keiretsu operates in Japan. Many European countries have comparable industrial systems.

Today there are economic enterprises of far greater size in Japanese companies than there are in the United States. This has very important economic implications. Japan's Mitsubishi group, for example, claims revenues greater than the combined revenues of

IBM, AT&T, IT&T, Chrysler, U.S. Steel, and Xerox. There are five other combines of that size in Japan.

In Europe, formation of massive industrial combines have begun to form once again. West Germany's Siemens Corp., for example, is operating with enormous hordes of cash—$13 billion.

The distribution systems in Asia are equally different from those in the United States. This too has very important implications for opening up Asian markets to American goods.

The question that we face pertains to how we deal with societies that marshal the whole of their resources for competition, given that our own system largely is based on traditional market approaches.

How do we deal with systems, for example, that place a national priority on production, and not consumption?

How do we deal with a society that permits—even encourages—the formation and operation of cartels?

How do we deal with a society in which massive quantities of national funds are funneled at the pre-competition stage for R&D and other activities which subsidize and help enterprises?

How do we compete in an environment in which, by the very structure of its enterprises, financial institutions are at the center of these combines, when we do not permit this involvement in our own country?

And how do we deal with our own mindset that encourages trade-offs among a triad of foreign policy, defense policy and economic policy? The European Community has some balance in its trade-offs; our society, on the other hand, has time and again traded its economic interests for defense and foreign policy considerations. We must not forget that we are competing with Asian economies—particularly Japan—in which economic interests are never traded off.

I disagree with Fred Bergsten that we should form a compact that would allow the State Department to negotiate America's foreign policy considerations separately from the Defense Department, and the military security considerations in the USTR separate from the economic considerations. It seems to me that what is required here is a meshing of interests.

We have also come to a point where we ask ourselves whether we are still able to lead the fight for GATT, as we once were. Today America is more vulnerable: we are now a debtor nation. And a precipitous increase in foreign investment in the United States means that many of the levers we might once have used—i.e., the U.S. market—have been weakened.

Therefore, a number of strategic issues require our attention. First, how do we reconcile the precepts of free trade with those of economic nationalism?

In our own mind's eye, free trade is a superior system, it works well, and it has certainly worked well for us. But we are dealing with other societies, in which the benefits of free trade may be secondary to national interest; in which the concept of long-term national well-being may be secondary to the considerations of individual consumer gains; in which production is emphasized over consumption. Can we reconcile that in a multilateral GATT system? I have some doubts.

Given the nature of the industrial structures of our competitors, a second set of questions must address how America deals with concepts as antitrust and cartel formation in a globalized economy?

How do we deal with the fact that U.S. firms often compete against large combines that work together, that work with the support of the government, that penetrate our markets, and that effectively can engage in practices that are forbidden for U.S. firms? More importantly, we have seen circumstances time and again which foster trade-offs of U.S. economic and trade policy for defense and foreign policy, when we have amply ignored these activities of our competitors.

In sum, I believe that the multilateral approach has an important role: it has certainly served us well in the past, at least until the 1970's. But we must remember the differences between American policy and practices and the policies and practices of our competitors. We cannot deny the fact that we no longer enjoy easy superiority. And we can no longer make the unbalanced sacrifices that we made in the past. Perhaps other approaches—approaches like the proposed Baucus compact—merit consideration today.

Senator BAUCUS. Thank you, Mr. Choate.

[The prepared statement of Mr. Choate appears in the appendix.]

Senator BAUCUS. The final witness is Mr. Robert Morris.

Mr. Morris?

STATEMENT OF ROBERT J. MORRIS, SENIOR VICE PRESIDENT, U.S. COUNCIL FOR INTERNATIONAL BUSINESS, WASHINGTON, DC

Mr. MORRIS. Thank you, Mr. Chairman.

I have to enter a bit of a disclaimer at the beginning, in that my appearance here today is in my personal capacity rather than that of an officer of the U.S. Council for International Business, and my views are my own and do not necessarily reflect those of the council.

I am delighted to have this opportunity to expand a bit on some of the views which I presented in an article that I wrote for the Brookings Review last summer, in which I outlined the case for a balanced approach to U.S. trade policy in the years ahead, stressing activity on three fronts: multilateral, plurilateral, and bilateral.

I would like to focus my comments today, Mr. Chairman, on the second of those three approaches, and particularly your suggestion about the desirability of extending a plurilateral approach to the countries of the Pacific Basin.

In the article which I wrote, my intention was to identify a market-opening alternative to the more widely discussed options of multilateral negotiations through the GATT or bilateral negotiations through separate comprehensive free trade agreements with a variety of different countries. In my view, these two options are neither mutually exclusive, as they have often been presented, nor do they encompass the full universe of possibilities.

I start from the premise that the interests of the United States require us to reverse the trend toward growing sectoral protectionism of the decade since the conclusion of the Tokyo Round of GATT negotiations, and to reestablish the momentum toward market-opening trade liberalization, which is the best guarantee we have of both national and global prosperity.

My main concern was to suggest an option to do that which involved less than full GATT participation or less comprehensive coverage than would be required in a GATT-consistent free trade area.

I believe that we can accomplish a great deal to reform and strengthen the GATT system in the current negotiations; however, I also believe that we must take other steps, both to make that expectation a reality and to capitalize on the opportunities that it will create.

Now, I would like to focus specifically on the suggestions that you made about a Pacific arrangement. I would like to suggest that, as an example of the plurilateral approach that I have advocated, a model for such an approach might in fact lie in the recently concluded U.S.-Mexico framework arrangement of 1987, but extended to organize our commercial relations and promote further market-opening agreements with several countries simultaneously.

Under that model, the agreement would be limited to establishment of a framework arrangement, initially with a core group of Pacific Basin countries—and we can discuss who they might be—but expandable later to include others.

The purpose of the agreement would be twofold: First, to establish principles and procedures which would supplement the commitments of the participants in the GATT as regards trade and investment relations among them; and second, to create a consultative or negotiating mechanism which can be used to clarify respective policies, resolve specific disputes, initiate cooperative projects for the development of trade and investment opportunities within the region, and specifically to negotiate the reduction or removal of trade or investment barriers.

Now, my prepared statement, which I hope will in fact stand in the record as my regular statement, does outline what the features of such an arrangement might be, and I would be happy to elaborate on those during the discussion period. However, in the time remaining for my opening presentation, I would like to move directly to questions of both how and when.

No trade strategy for the United States will succeed if it ignores two fundamental realities of the next few years:

The first is the global commitment to conclude the Uruguay Round by the end of 1990. The United States has too much at stake in the maintenance of a viable multilateral system, and the need for improvements in it, to permit any other initiative or preoccupation to destroy the opportunity for real progress in that round.

However, the initiatives that I have suggested, I believe, can help stimulate those negotiations to higher levels of achievement, and in the longer run can help strengthen the GATT itself by providing a forceful example of what real market opening can accomplish for an even wider circle of participants.

Now, the second reality is the set of new requirements in the 1988 Trade Act for the administration to be much more aggressive in bilateral negotiations to deal with unfair practices and remove barriers to American exports.

The United States cannot devise strategies for dealing with Japan or any other country in a vacuum which denies those imperatives or pretends that action on them can be compartmentalized in ways that have no effect on other initiatives.

Thus, the Government, both Congress and the Executive, must work out a strategic plan which permits an optimum outcome on each separate front.

There are several conceivable ways of meeting the new Trade Act requirements, and especially those mandated in Section 310, the so-called Super 301. I will leave it to you to determine how each of those possibilities might fly in the Congress.

However, I would like to emphasize that, if it is ultimately decided that some East Asian countries ought to be designated as priority under Section 310, why not try to make a virtue of necessity? Instead of apologizing for such a process, or getting excessively self-righteous and belligerent about it, why not stress that designation is an invitation to join with the United States in creating a new relationship, a mutually advantageous relationship of mature allies, rather than a mutually recriminating relationship of bickering adversaries?

The more constructive alternative is one which offers the real prospect of putting our grievances behind us, as a source of constant irritation and stalemate, in favor of a real trade-liberalizing action across a broad front and involving several key countries in the Pacific region. It is designed to build from foundations laid in the GATT negotiations, and not compete with or detract from them. It is a relationship from which all stand to gain and, therefore, to which all are more likely to contribute willingly, rather than one that results in grudging acquiescence to unilateral demands and which only stimulates the search for ways to get around the commitments that have been made.

However, it is also an invitation which is not open-ended in time. Section 310 imposes certain deadlines and other constraints which preclude a leisurely or complacent approach. These cannot be ignored—they are, after all, the law.

But I would hope that the Congress and the administration could work out understandings on implementation which would provide the flexibility that may be required if real progress toward the arrangement I have recommended justified it.

I will reserve the rest of my time for questions. Thank you very much, Senator.

Senator Baucus. Thank you.

[The prepared statement of Mr. Morris appears in the appendix.]

Senator Baucus. I would like to begin, first, Mr. Bergsten, by asking you to very briefly outline the reasons for your institute's conclusions that under current law and current exchange rates, and if all things remain as they are, that I think you said the current account deficit with Japan will increase to $140 billion in 2 or 3 years, or 4 years. I have forgotten your precise dates. Could you tell us why that is going to happen?

Mr. Bergsten. Our estimate is that Japan's global current account surplus would rise to something like $140 billion, of which roughly half would be bilateral surplus with the United States.

The reasons are severalfold:

First, the exchange rate changes that brought the dollar down so sharply against the yen essentially had occurred by the end of

1987, and it takes about 2 years for those exchange rate changes to play through into changes in the trade balance. So, by the end of 1989, most of the gains that we got from the depreciation of the dollar would be worked through, and no further improvement wouldoccur from that quarter.

At that point, the fact that U.S. imports are still running close to double U.S. exports would begin to take over again. If imports are much higher than exports, and both start growing at the same rate, the imbalance grows at a very rapid pace. And that explains, then, why the deficit would start to grow again.

But, Mr. Chairman, the fundamental reason for the widening imbalance is that domestic demand in the United States continues to rise at a much faster rate than the growth of productive output. We are now very close to full employment. So, if our domestic demand growth continues at 3 or 3.5 percent, we are simply going to have to increase our trade deficit to satisfy domestic demand. We cannot increase domestic production to satisfy that growth in output.

In essence, we as a country are still spending a lot more than we can produce at home. The reasons for that, in my view, relate basically to the budget deficit. So, having gotten the 2 years of gains from the exchange rate decline, which brought the deficit down very sharply, we would again start to deteriorate.

In the Japanese case, one sees almost the reverse situation, in one sense. Japanese exports are much higher than Japanese imports, and even though their imports have been growing faster than their exports, the beginning imbalance is so great that their surplus is again rising. So, you have the legacy of huge imbalances, going back to their peaks in 1985–86, the fact that the effects of the currency changes that have already taken place will peter out this year, and the underlying imbalance in the U.S. economy, with domestic demand growing so rapidly.

The main conclusion is that we have to slow the growth of domestic demand in our own economy, if we are ever to get our external imbalance under control.

Senator BAUCUS. All right. If that is the case, let me explain why I think we should proceed along the lines that I outlined. I hear you making a case that we have got a problem. We have got to address that problem in America.

Now, I also tend to believe that the GATT is not going to solve the problem, for a lot of reasons. First of all, the GATT was intended to be an interim measure. It was not set up to manage or to deal with international trade relationships; it was supposed to only be an interim measure.

Second, it was put together at a time when the United States dominated the world's economy, and it was basically set up with the view that the United States could, if not dictate its will, certainly have a preponderant influence. And not only that, the world has changed so much since the GATT was set up—it doesn't cover services, intellectual property, agriculture, textiles, capital goods, et cetera. In fact, most of the world's commerce is not covered by the GATT today. But more fundamentally, the GATT is premised on process, its rules.

You have just described an imbalance, an American imbalance with another country—that is, Japan—which I think most observers will think is less of a process-oriented economy than a results-oriented economy.

If the United States is going to begin to get its economic house in order, it seems to me that we have to somehow shift the balance a little bit away from process and more toward results.

What I am trying to do with this idea of mine is to help move the United States in that direction, to encourage us to be more results-oriented and a little less process-oriented. That is not to say we shouldn't maintain the legal processes that we have; but what I am saying is, in order to get results, we are going to have to be a little more results-oriented.

It seems to me that, because most of our trade imbalances are with Japan and other Pacific Rim countries than with other countries, we should try to focus on that part of the world and set up a more results-oriented framework. Namely, we should negotiate with Japan and other Pacific Rim countries some specified reductions in trade deficits, some specified reductions in our side of budget deficit reductions, which will help address what you mentioned, the deficiency in our economy, and help negotiate consumption increases perhaps in Japan, just on the macro side, and also some kind of exchange rate coordination.

So, why isn't it true that this kind of an approach will in fact complement the Uruguay Round? Because I start with the premise that the Uruguay Round is not going to help very much, even if it is moderately successful.

You said we should proceed along this direction, but why shouldn't we proceed with a little more dispatch, and somehow better coordinate—State, Treasury, and USTR—in a way that forces the United States to set some priorities?

I think our priority should be an economic priority; that is, we have got to get this trade deficit reduced with the Pacific Rim. It has to happen. We have to in this country start figuring out ways to increase our net savings rates, and national savings rates. It just has to happen.

My thought is that, if we do negotiate an agreement with Japan and other Pacific Rim countries, it is going to force us to set those priorities; it is going to force us to better address economic as opposed to political difference with other countries, with the Pacific Rim. Why shouldn't we proceed?

You talk about proceeding as usual and somehow consulting and coordinating this. Why shouldn't we set up a negotiation which tends to force us to more likely coordinate and to set some priorities?

Mr. **Bergsten**. I think you have put your finger on the crucial issue. I referred to it in my written statement but, because of time limitations, I didn't mention it in my oral comment.

I think you are absolutely right that we must get our own house in order, raise our national savings rate, deal with the budget deficit, and improve the competitiveness of the American economy.

You are making a crucial judgment that entering a negotiation with Japan, that would bring together this array of issues would in turn galvanize the internal U.S. process in the direction that you and I both want.

Senator **Baucus**. That is correct.

Mr. **Bergsten**. I think the critical question is whether that would in fact occur, and if so, why?

Let me put a question back to you as a Member of the U.S. Senate. Suppose the United States were to launch such a negotiation. Would that break the budget deadlock here on Capitol Hill? Because the most obvious single step the United States should take to get our national savings rate up, to stop excessive consumption, to put our own domestic house in order, almost everybody agrees, is to eliminate the budget deficit, which remains unhandled despite Gramm-Rudman targets and everything else.

Now, if you could tell me that launching this effort with Japan, or in the Pacific Rim more broadly, would turn the tide on our internal political process, and thereby get us decisively on a path that would eliminate the budget deficit over 4 years—which I will confidently tell you would be by far the best step toward getting our trade deficit under control—then I think you would convince me to go with your program.

Senator **Baucus**. Well, I am going to answer that question by saying I am not sure I know the answer to that question. I don't think anybody does.

But I tend to think that the President and the Congress are more likely to achieve meaningful deficit reduction, as opposed to smoke and mirrors—the more we in America see that in fact Japan commensurately or proportionately is stimulating its consumption, opening up its borders, addressing the distribution problem, and so on and so forth. I think that would be a factor.

My thought is, if we can enter into negotiations with Japan, then each country can help the other country do what it knows it should be doing.

Mr. **Bergsten**. Well, I agree fully with the objective. Let me tell you my fear. My fear is that pushing in the direction you suggest might, given domestic politics here, have very little effect on the things we need to do at home, and that instead it would provide a convenient excuse for a copout, and enable the American political process to say, "It is up to the Japanese now"—not just to maintain domestic demand growth, which they are doing; not just to let the yen rise by 100 percent in value, which they have already done; but to bust up the Keiretsu, change the distribution system, get rid of agricultural protection, and do all of those things that we want and are essential and that the Japanese should do in their own interest.

But I am afraid that if you put it in this context, then the inevitable slowness of the Japanese to do all those things would be used as an excuse back here not to do what we should do anyway.

Moreover, it would, as I suggested earlier, run the risk of undermining the multilateral process.

Now, I don't have a handy answer for you on how to get the multilateral process to galvanize us internally to do what we should. I have ideas about target zone systems, which I know you share, on a multilateral or at least a G-5 or G-7 basis that I think could be used in that direction.

I worry that the effort to conclude a bilateral deal with Japan might have effects different from, even opposite to, what you put forward. But, I admit, it is a matter of judgment. If you really thought it would galvanize our internal process, then you would have a convert.

Senator BAUCUS. Dr. Choate, do you have any thoughts on this subject?

Dr. CHOATE. Yes, I do.

First, I do not think that we should be looking for an external stimulus to deal with what are very naturally domestic measures that must be taken with the budget deficit. Nor do I think that any measures that we might take in trade negotiations would lead to that. I think they are separate topics. So it seems to me that the measures to deal with the budget deficit are going to have to follow their own track.

Second, I see nothing to suggest that the Japanese are going to make the internal changes that are required internally without outside pressure and stimulation and negotiation—with the Keiretsu, the distribution system, and with the dominance of the agricultural interests.

Senator BAUCUS. What about that, Mr. Bergsten? Isn't outside pressure needed on Japan?

Mr. BERGSTEN. Oh, yes.

Senator BAUCUS. What is the best form of outside pressure?

Mr. BERGSTEN. I think the Japanese have given us a clear signal, on every issue, year after year, that they need pressure in order to be able to move internally. The issue is what type of pressure.

Senator BAUCUS. But if we pursue it on the Uruguay Round, it seems to me that is not going to be very much pressure.

Mr. BERGSTEN. Well, a combination of the Uruguay Round, with the negotiations on individual sectors already mandated under Section 301, and continuing what we have done the last 2 years, although it amounts to slogging away in the trenches, probably will lead to about as good results as you would get more broadly.

My fear, as I said, is that you could actually undercut the Uruguay Round if you launched a big bilateral deal with Japan. Then I think you would have thrown out the baby with the bath water.

Senator BAUCUS. I am sorry, Mr. Choate, I interrupted you. Why don't you go ahead?

Dr. CHOATE. The other point is, I think we are too fearful of destroying the Uruguay Round by these types of arrangements. The U.S.-Canadian Agreement isn't going to threaten the Uruguay Round. Europe 1992 is not threatening the Uruguay Round. The closeness of the Japanese market itself may actually threaten the Uruguay Round.

We find, as the Japanese will not take goods from other Southeastern countries, those goods wind up being diverted into the United States, which raises pressures, which causes great difficulties.

And I would say one other thing. The Uruguay Round has shared benefits for Europe, for the Japanese, and for other countries. They have a shared responsibility to continue those rounds.

If we assume that the burden falls exclusively on the United States to provide the leadership in those rounds, we are setting ourselves up, then, to make disproportionate sacrifices. It is shared benefits; it should be shared responsibilities.

I think if we have negotiations such as this, then we are more likely to ensure the success of those rounds; we will put pressure to that.

Senator BAUCUS. Mr. Bergsten, what about that? The Canadian agreement hasn't destroyed the Uruguay Round. What about the points that Dr. Choate mentioned?

Mr. BERGSTEN. I agree. I was a strong supporter of the U.S.-Canada Agreement. But I think there is literally a world of difference between the U.S.-Canada deal and a U.S.-Japan pact, either of the type you propose or simply of the more conventional free trade type.

The first reason is, of course, geographical propinquity. The United States and Canada are huge trading partners, and trade is already pretty free and roughly balanced between them, or at least much less imbalanced than trade between the United States and Japan. The U.S.-Canada agreement is regarded, I think, in both countries and around the world as fully compatible with the GATT. Indeed, I have heard GATT experts say that the U.S.-Canada deal is the most compatible with the GATT of any bilateral trade deal ever struck; that is, it includes most trade and meets the test of article XXIV.

Would a U.S.-Japan bilateral trade pact come anywhere close to meeting the tests of the GATT? Would it include agricultural trade—which we would certainly insist on? Would it include the things Mr. Choate wants to hit—the distribution system, the Keiretsu? Technically, how could you include these things? And if you didn't, would the U.S. Congress approve the deal?

We go into the U.S.-Japan relationship with a huge imbalance. Indeed, correcting that imbalance is one of your targets, and rightly so. Would the United States agree to a free trade agreement with Japan that did not include changes in all of their practices and policies that we felt were necessary to bring down that imbalance very, very sharply?

Senator BAUCUS. Why would an agreement with Japan that did address distribution be incompatible with the GATT?

Mr. BERGSTEN. No, if it did include all of the things that Mr. Choate has outlined, then it would be very compatible with the GATT. I am expressing grave doubts not only that you could get that in negotiating terms but that there is technically any way to do it.

Senator BAUCUS. But is it worth trying?

Mr. BERGSTEN. Well, it is worth trying. But that comes back to the dynamic of trying, and how the effort to do it would affect the multilateral process. I would like to hear from Mr. Choate.

Senator BAUCUS. What if it is non-discriminatory? Isn't a non-discriminatory agreement less likely to threaten the GATT?

Mr. BERGSTEN. Yes. And I think if you negotiated an open-ended agreement, or an agreement that generalized all of the benefits, then in fact you would meet that test of the GATT. But to me, the first test of the GATT that would have to be met is the test that the Common Market supposedly met, and that the U.S.-Canada deal does meet, namely, the coverage of virtually all trade.

What I want to hear from Mr. Choate or other advocates is how a bilateral agreement would break up the Keiretsu, how it would alter the distribution system. I have in mind some ways to do that, but I don't think they stem from a bilateral trade agreement.

Senator BAUCUS. All right. Dr. Choate?

Dr. CHOATE. It may not be possible to break up the Keiretsu. It may not be possible for the Japanese—in any meaningful time period—to alter their distribution system, and it may not be possible for them, given the dynamics of their internal politics, then to deal with the imbalances that they have in agricultural trade.

Now, the question that we face if they are unwilling to do that under a reasonable time period, is this: How do we respond? Do we continue to run these current imbalances and allow Japan's trade-distorting to occur?

Mr. BERGSTEN. Mr. Chairman, your proposal, in a very interesting and creative way, brings together three different sets of issues, and it might be useful to try to sort them out.

You talk about results versus process. That is one set of issues. A second set is multilateral versus bilateral—a completely separate set of issues. A third is GATT-type trade policy negotiations versus macromonetary types of negotiations. These are three separate issues, and I think it is very important to keep them clear.

You could establish a very results-oriented approach through a multilateral macroeconomic focus. That is what I want with my target zone proposal, and I know you endorse that to a wide extent.

If you could get a meaningful target zone system adopted by the G-7, G-5, G-3, or G-2, which set current account objectives and then set macroeconomic policies and exchange rates to meet those objectives, you would have it. And nothing could be more results-oriented. I simply think that is more likely than achieving it in either the bilateral or the GATT-oriented framework.

Senator BAUCUS. Well, this can go on forever. [Laughter.]

Senator Danforth just arrived.

Mr. BERGSTEN. Mr. Chairman, could I add one question to Mr. Choate, since I made a little headway in the last one?

Senator BAUCUS. Sure.

Mr. BERGSTEN. In his opening statement, he railed about these giant combines that we face in the rest of the world, and he mentioned the Japanese trading groups and one or two European companies. I would like to ask him why we have to be so afraid of these giant combines.

One, why is "big" beautiful? I am not sure that there is any evidence that bigness means international competitive success. As we look at the U.S. economy, some of our big firms are viewed as dinosaurs. They are not viewed as our most competitive firms. Our export success, our competitive success, has come from small and medium-sized firms, the American Business Conference companies. Their exports have been booming. It is the same story abroad. Why is "big" so much to be feared?

Two, why do we fear combines? I thought cartels were bad for competitiveness. I have never seen any evidence that cartels succeed in international trade better than market-oriented companies and firms. Indeed, I think one of the big mistakes of U.S. trade policy in the last 10 years is that we promote foreign cartels.

When we put in place auto restraints, steel restraints, textile restraints, or machine tool restraints, and ask the other country to allocate those quotas, limit access to our markets, what they then do, of course, is drive the price up 20, 30, 50 percent, rake off $1 billion or $2 billion more in profits, and augment the competitive position of their firms over time.

U.S. industrial policy has promoted the industrial competitiveness of our main competitors. And if you don't believe me, talk to the Japanese. They will tell you, in their honest moments, "We love your American trade controls. We have been carrying them to the bank for the last 10 years. Please do them some more."

In the automobile sector, we increased the profits of Nissan, Toyota, and Honda by over $2 billion in 1984, and again in 1985, and they plow those profits back, improve their competitiveness, and increase their market share.

We promote foreign cartels, and I know of no evidence that it helps our competitiveness.

Senator BAUCUS. Okay.

Dr. Choate?

Dr. CHOATE. Well——[Laughter.]

Senator BAUCUS. Briefly, please. [Laughter.]

Dr. CHOATE. Mr. Bergsten asks whether "bigger" is better. "Big" gives deep pockets. With deep pockets, a country can engage in both long-term activities and in predatory practices that underprice its goods and services and drive its competitors out of the market.

With regard to cartels, what we find, by and large, are these combinations of industry-state relationships that are cartels, that work together, that are guided by their governments. When they penetrate our markets, we often do not see them for what they really are.

The clearest example of this is underscored by the way Japan's television cartel dominated the television industry inside the United States. When private U.S. companies—Zenith, Emerson Electric—then National Union Electric—went to the Supreme Court, the U.S. Government also went to the Supreme Court and filed an amicus brief on behalf of the Japanese companies. Our government made a very intriguing argument: "Please find on behalf of the Japanese cartel and companies, because, if there is an antitrust violation, it was due to 'sovereign compulsion,' and of their state makes them do it, the companies should not be held accountable." Moreover, our government pleaded a case on behalf of Japan, effectively arguing, "This should be done because of defense and foreign policy considerations."

The point that I make is that, either in our trade policy or in our antitrust policy, we must find a way to deal with these cartels if we are to have the market benefits that Mr. Bergsten and I both want to see in this economy.

Senator BAUCUS. Thank you very much.

Senator Danforth?

OPENING STATEMENT OF HON. JOHN C. DANFORTH, A U.S. SENATOR FROM MISSOURI

Senator DANFORTH. Mr. Chairman, thank you very much.

I want to apologize to the panel for being in and out of the room so frequently during their presentation.

I don't really have a question. I would like to make a comment, if that is permissible, Mr. Chairman.

Senator BAUCUS. Certainly.

Senator DANFORTH. I want to say that I really don't like comprehensive bilateral free trade agreements. I just don't like them. I think that they are traps.

I think the reason they are traps is that, when the United States gets involved in bilateral agreements, it is on the basis of what we allege to be special relations with the country with which we are negotiating, and the special relationship means that it is not just a commercial deal—it involves all kinds of cultural or diplomatic engagements. As a result, once you begin negotiating a bilateral agreement, it becomes unthinkable to walk away from the table. It can't be done, because it would be viewed as such a major event between the two countries, which share a special relationship.

So, I think that bilateral agreements are too personal, and that there is too much pressure to consummate the deal.

You know, in resent years we have been increasingly concerned that international trade has been relegated to second or third place compared to other considerations we have as a nation. Most recently, for example, some of us who have looked at, the proposed FSX deal with Japan wonder why the Commerce Department or USTR weren't even part of the negotiations from the very beginning.

That is my concern, the same concern about bilateral trade agreements, that the President and the State Department have a tremendous interest in bringing the agreements to fruition.

I was in Senator Baucus' position during the Israel-U.S. agreement. I was chairman of the Trade Subcommittee and had a big role to play in that legislation—and I was glad I did. I think it was important for the general relations between Israel and the United States, but as a commercial deal.

And then you get to the agreement with Canada, where I felt that we really made major concessions to Canada, that it was not a good deal overall for the United States but that we were locked into it. And then, we didn't really even buy ourselves much friendship, because the Canadians thought that they had been euchred. So they had this major flap and anti-American uprisings in Canada in connection with a deal that we felt was absolutely necessary.

I can remember early in that process with Canada when we were granting negotiating authority to the administration, we had a very close vote. In fact, it involved having the President of the United States, President Reagan, call the Senate Finance Committee up to the White House. And I can remember the President looking across the Cabinet table at me and saying, "Just what the"—expletive deleted—"do you think you are doing?"

So, that is the nature of my concern, and thank you very much for indulging me. [Laughter.]

Senator BAUCUS. Thank you, Senator.

Mr. **Bergsten**. Could I make two observations real quickly on what the Senator said?

The first is, maybe he has defined the outcome for any successful trade negotiation; you know, if each country thinks it has been euchred, therefore maybe that is why you have a deal.

But the broader point was maybe to link what he said with something that came out of our conference that we had on this topic a few months ago. Senator Danforth said that the United States should not get into bilateral deals because other countries would then benefit, the U.S. feeling at that point, "Can't walk away from the table; have to maintain it."

That is consistent with a very interesting conclusion that came out of our conference. Every single country that presented a paper from its standpoint on a bilateral deal with the United States was very interested in the prospect—Korea, Taiwan, the ASEAN countries, Japan, Mexico; exception for Australia. But maybe they take the same view that Senator Danforth does, that once into a deal like that, you get special treatment.

Senator **Baucus**. That works both ways, then, that they can't walk away.

Mr. **Bergsten**. Well, if they get special treatment——

Senator **Baucus**. It is special treatment.

Mr. **Bergsten**. Well, I have the view that they are kind of hard-nosed types.

Senator **Baucus**. What you are saying, then, is an indictment of the U.S. system, not of bilateralism per se. That statement is really a statement that the United States tends to put political——

Mr. **Bergsten**. Oh, I am prepared to indict the U.S. system. [Laughter.]

Let me do away with these amenities.

Senator **Baucus**. Mr. Morris hasn't had a chance to comment on this.

Senator **Danforth**. Can I just say, in response to Fred, I think when other countries approach the negotiating table, they approach it from the standpoint of a national policy which is designed to foster the commercial interests of the country, even targeting industries, and they ask themselves, "What can we do to improve our economic situation?"

I think when the United States goes to the table, that is a secondary or even tertiary interest, and that the primary interest is in overall foreign policy terms, particularly when we are close enough to the country to be speaking with them bilaterally in the first place.

Mr. **Bergsten**. Just to be clear on that, I agree fully with Pat, that the United States has not given adequate priority to these issues. The difference between us is in how to go about it.

Senator **Baucus**. Mr. Morris, do you think bilaterals are a trap?

Mr. **Morris**. Well, to a certain extent they are, and that is why I think we ought to look for other options.

Senator **Baucus**. Exclusively? Should we forget bilaterals entirely?

Mr. **Morris**. Well, there is a limited scope for further bilaterals. I mean bilateral free trade agreements, in the sense that we have done one with Canada.

Senator **Baucus**. Oh, I don't mean that kind. I am talking about more bilateral negotiations.

Mr. **Morris**. Well, Senator, forgive me. Maybe it is a semantic problem, but the Trade Act mandates a whole lot of negotiating between now and the next couple of years about trade problems, and they mandate them on basically a bilateral basis.

I don't regard those, however, as bilateral trade negotiations. I regard that as making unilateral demands to which the other party must accede, "or else." And it is the "or else" that bothers me and worries me very much.

That is why I think we have to establish—I recognize the fact that you are not wildly enthusiastic about process arrangements, but I do believe we need a framework, some kind of a process which permits us to manage these problems in a way which does not result in the breakdown of the trading system, the open trading system.

And believe me, Senator, it is under a very, very severe threat, not just from the so-called unfair trading practices of others but not least from the potential for the United States to go off on its own on basically a unilateralist direction.

That is why I think we really have to look more carefully at what the other options are. I am not as pessimistic as you are that the GATT negotiations will not bring forth satisfactory agreements; but, there is no question but that they will not be so fully satisfactory as we would like, primarily because we cannot expect some of the developing countries, particularly, to accede to all of the things that we would like to have accomplished in that round.

Now, I view the proposals which I have made for plurilateral arrangements among like-minded countries to be a way station, a way station on the road to more extensive GATT commitments among countries, and certainly as a vehicle for bringing a greater degree of coherence into the trade strategy which we are trying to mobilize among various countries, and particularly, as I say, through this process that we have initiated ourselves in the Super 301.

May I also make a distinction about the results-oriented trade policy for which you appealed earlier?

I think I have to agree basically with Fred when he suggests that if we want real results on the U.S. trade deficit, we must look to the macroeconomic coordination process as the primary instrument.

Indeed, if the results that you are looking for are primarily to be expressed through commitments by another country—let us say, for example, Japan—to increase its imports from the United States, you are really sending a signal to the rest of the world that the United States is no longer interested in a non-discriminatory trading system, that what we really want is that the Japanese Government will assure us will bring results to the United States.

If, on the other hand, you are looking for commitments from the Japanese that the government would enforce to get imports increased from all sources, so that you remain consistent with the GATT requirements, I don't know why it is that the U.S. Government as to expend a lot of its negotiating capital arguing for a process that may indeed end up benefiting other countries more than us. In other words, it is not U.S. exporters who directly are going to benefit from that.

On the other hand, I do see some scope for using results as a criteria, in particular sectoral problems. Now, I think that this scope is indeed extremely limited; but, let us take as a case in point the problem of rice in Japan.

Here the problem is fundamentally one in which the government is responsible; it is a government policy that effectively keeps rice out of Japan. Second, it is an area in which U.S. suppliers are certainly highly competitive on world markets. Whether they have the desire to go off and really make an effort to get into the Japanese market depends entirely, or almost exclusively, on them, but it is something that we need to be assured of. But it is an area or sector in which we could look in fact to results as a touchstone for determining whether or not the agreement that would be made is in fact working, because we can assume that the United States would be the competitive supplier, or one of the most competitive suppliers.

I don't think that that possibility, however, exists well beyond very many sectors in which the United States really does have that kind of competitive clout, and where—and it is terribly important these days to bear this in mind—where we have the excess capacity in order to supply these markets.

So I would just conclude by again making a pitch for something less than a total free trade agreement, certainly more than an arrangement which is simply used as a battering ram to insist that other countries unilaterally exceed to whatever our demands are, and less than perhaps we can fully expect from the GATT, but which could act as a strong stimulus to further expansion of the liberal trading system in the GATT. And whether we do it contemporaneously or in sequence, I think, is a tactical issue.

But I think we cannot ignore the Super 301 problem, and therefore negotiating an arrangement such as I have suggested, in which you are looking toward establishing a framework arrangement that will permit you to resolve disputes, is something that we ought to seriously take into account as we proceed in the first tranche of the 301 system, which must be undertaken not later than May of this year.

Senator BAUCUS. Let me just try to sum up.

I have the sense that, first, Europeans in 1992 are going to try to protect their agricultural system to a large degree. I therefore sense that it is going to be difficult for there to be much progress in the Uruguay Round. The problem is the timing; 1992 is 2 years after 1990.

I sense that, therefore, the Uruguay Round is going to eventually not accomplish much in 1990, until Europe 92 is more definitely resolved. This means that perhaps there will be some results of the Uruguay Round in 1990 but maybe significant results will be postponed to 1992, so that the Europe 92 is somehow dovetailed into 90 as the problems of 92 are worked out.

My thought is that, at the same time, it may therefore be important to us to enter some plurilateral agreements—non-discriminatory—with the Pacific Basin, both to help encourage 92 and Uruguay to be more in the way we would like it to be—that is, more open and address more comprehensively more subjects—and also as potential insurance to some degree in case 92 or 90 break down, and don't really do what they should be doing.

I am just curious how each of you would react to that. I will start with Dr. Choate.

Dr. **Choate**. I agree with your logic. It seems there is almost a chain of thoughts among us here.

First, the macroeconomic measures are essential but insufficient.

Second, it is important that we do all that we can to ensure the success of the current GATT round.

Third—and here is where we have some disagreement—is that one of the ways we can enhance that possibility is by considering and perhaps implementing some other flexible negotiations—plurilateral, bilateral—particularly along the lines of Mr. Morris' insight.

And the fourth thing that we should do is make aggressive use of the requirement of the 1988 Trade Act that the USTR come forth with a trade strategy which implies something more than dealing ad hoc with individual problems.

It seems to me that that may be one of the most important things of all, so that we may balance our foreign policy, our defense, and our trade interests.

Mr. **Bergsten**. Well, the critical question is Mr. Choates' third point. That is where we have disagreed, on whether an effort now to negotiate bilateral or regional deals would promote or undermine the Uruguay Round.

If the Round were to fail, I would then be the first to say you have to look for alternatives, and at that point bilateral talks might turn out to be the name of the game. But I do fear, for reasons I have indicated, that they would undermine the effort now.

I do have one specific thought that relates exactly to what you said about the relationship to Europe. I agree with the risk you pose.

Suppose for a moment the Uruguay Round achieved its maximum success, whatever that was, and ended in 1990, and then the European process went on. The Europeans, like everybody else, leave the tough issues to the end, so they would be negotiating the hard issues in 1991 and 1992. The pressure would be to export some of the costs to the outsiders. This is particularly important because by then we may have a world recession, and the Europeans are going to have to accept a big reduction in their trade surplus to accommodate our improvement, et cetera, et cetera.

I therefore think we should make a virtue out of necessity: Change the target date for the Uruguay Round to 1992; keep the Europeans' feet to the multilateral fire all the time that they are pursuing their internal regional negotiation, so that the disjunction in time that you mention would not take place, and that right from now we would be making it clear that the two processes have to move in sync.

I think that would help deal with the problem. It would add, in my view, to the need to put all the focus on the Round rather than on other regional talks that might encourage the Europeans to tighten their own regional pact rather than work multilaterally.

Senator BAUCUS. You know, 1992 is a way off, and in the meantime our deficit is getting worse and worse, and our economy is going down the drain.

Mr. BERGSTEN. But, Mr. Chairman, we do have to be clear. I think we cannot expect either the Uruguay Round, or the U.S.-Canada FTA, or a U.S.-Japan trade agreement of any type to do very much about our trade imbalance.

This may be a fundamental point of difference between me and others. But I really see no conceivable way that any other country is going to negotiate a bilateral agreement with us, and then go back to its parliament and public opinion and say, "The objective of the exercise was to reduce our trade surplus with the United States by $30 billion." That is not going to happen.

If the notion that we sought improvement in the trade balance through the U.S.-Canada FTA had ever been mentioned in the Canadian election, Mulroney would have lost and Turner would have won, and there would be no FTA. You can't pursue trade balance goals through trade policy agreements.

Now, your approach broadens the thing, but that is a separate component of it. We just can't have the illusion that FTA's——

Senator BAUCUS. I am not talking about FTA's. My thought is that Japan, whoever is Prime Minister in x-year, could more easily go to his parliament and say, "Yes, an objective is to reduce the trade deficit; but in addition, we have succeeded in getting the United States' budget deficit reduced, and their private savings rate up," and so forth.

I think both Japan, for example, and the United States realize that as one goes, the other goes, too.

Mr. BERGSTEN. Right.

Senator BAUCUS. That we are in this world together, and we have to figure out how to get along together.

Mr. BERGSTEN. I fully agree. If he could say that, then he would be in a stronger position. But that goes back to the question before.

Senator BAUCUS. I understand.

We interrupted, so quickly, Mr. Morris.

Mr. MORRIS. I just would comment on the EC-92 process. The timetable for the adoption of those directives, the roughly 300 directives, is to adopt them by the end of 1990 and to have them implemented, or most of them implemented, by the end of 1992. That means, Fred, that we are contemporaneous with the GATT round.

The second comment I would make is that I think it is easy to exaggerate the deleterious effects of this program on American interests, both as exporters and investors, and to overlook that it also has the potential for being a major contribution to both our own economic and business interests as well as that of an open world trading system.

Therefore, the burden is really very much on our negotiators to manage a two-tack process:

One is to exploit to the maximum extent possible the opportunities of the Uruguay Round, to nail the Europeans down to as open agreements as possible in such areas as services and government procurement, where the major challenges to American interests right now seem to be shaping up.

The second is to manage the bilateral relationship with the Europeans in such a way that we can constructively come out of this process ahead of the game. And I have in mind particularly the need to do something about the standard-setting process between the United States and the Europeans, because right now it is quite unsatisfactory, and it has the potential for being far more damaging to American export interests and indeed to the globalized strategy of most American companies than does virtually anything else that is in that program.

That is going to have to be resolved primarily through bilateral talks and bilateral mechanisms, with a strong re-invigoration of the International Standards Agreement that was done in the last GATT round.

Mr. SCHOTT. Mr. Chairman?

Senator BAUCUS. Mr. Schott, and then that has to be it.

Mr. SCHOTT. One final point, and that is on agriculture, since you mentioned your view that not too much would be accomplished.

I would caution against putting too much weight on an overall result in agriculture for the Uruguay Round. I think half a loaf on agriculture would still be very nourishing, and it would be perhaps as much as would be tolerated in the political system, both here and abroad.

I know, as a former negotiator, one has to worry about how it is going to be received when we come back home and bring it before you and your colleagues here. I think perhaps we have been overestimating what will be acceptable to the U.S. farm community as far as total elimination of farm subsidies.

So I would just give that one caution, as far as the extent of results that are feasible and desirable on agriculture.

Senator BAUCUS. I want to thank you all very much for helping us finally decide this issue. [Laughter.]

Thank you very much.

Mr. BERGSTEN. Thank you, Mr. Chairman.

Senator BAUCUS. Our next panel will be Mrs. Doral Cooper, who is president of C&M International Ltd., a former Assistant USTR for Asia, Africa, and the Mid-East; and Mr. Michael Aho, director of economic studies, Council on Foreign Relations; and Mr. Guy Erb, director of the U.S. Council of the Mexico-U.S. Business Committee.

Mrs. Cooper, why don't you proceed first?

Mrs. COOPER. Thank you.

STATEMENT OF DORAL S. COOPER, PRESIDENT, C&M INTERNATIONAL, LTD.; FORMER ASSISTANT U.S. TRADE REPRESENTATIVE FOR ASIA, AFRICA AND THE MIDDLE EAST, AND CHIEF NEGOTIATOR, U.S.-ISRAELI FREE TRADE AGREEMENT, WASHINGTON, DC

Mrs. COOPER. Good morning, Mr. Chairman.

I appreciate the opportunity to appear before the committee today to discuss free trade agreements, as well as to appear with two old colleagues from the trenches of trade policy formulation. We have had many debates in the past, and I expect we are going to have another one this morning.

My name is Doral Cooper. I am the President of C&M International, an international trade and consulting firm. Although C&M International represents countries in the Pacific Rim, I am appearing today on my own behalf.

I was formerly the Assistant U.S. Trade Representative for Asia, Africa, and the Middle East, and in that capacity I was the chief negotiator for the U.S. Government for the U.S.-Israeli Free Trade Agreement.

I want to share the history of that experience with you today, as well as my support for additional FTA agreements. I will begin with background on the genesis of that agreement.

The Government of Israel suggested an FTA to the United States in 1981. The U.S. Government was at first reluctant to pursue the suggestion, because we had never negotiated a bilateral FTA in the past and were historically and philosophically committed to the multilateral process.

However, multi-country negotiations in the GATT were stalled, and the multilateral system was not addressing many issues of keen importance to the United States, such as trade in services, investment, and the protection of intellectual property rights.

The major debate surrounding the possible commencement of the negotiations was very similar to debates which have been held subsequently concerning the negotiation of additional FTA's and to the examination of the issue here this morning.

Should the United States embark on a course of comprehensive bilateral negotiations? Would such a course spell the end of the GATT system?

Numerous, long and often acrimonious inter-agency discussions were held on this very subject, including two Cabinet meetings. In the end, it was decided to move forward, for the following reasons:

First, the FTA negotiations would not replace the GATT; in fact, FTA's are sanctioned by the GATT in article XXIV. Second, FTA negotiations would provide a model for trade liberalization for the rest of the trade community, and they would allow the United States to introduce in a concrete way new subjects of international trade negotiations, increasingly important to our economy. The reasons that gave rise to the U.S.-Israel FTA are no less true today than they were in 1982.

Another part of this brief history is important to our discussions today. The U.S.-Israel FTA was meant to be a model for additional agreements to follow. In fact, before those negotiations began an offer was extended to Egypt to negotiate a similar accord when and if that country was ready. Likewise, then-USTR Ambassador Bill Brock suggested the initiative to the member countries of ASEAN in 1983. And as hoped and expected, the agreement with Israel provided the foundation for the successful FTA negotiations with Canada.

The U.S.-Israel FTA agreement has had a significant positive effect on U.S.-Israeli trade and investment. The FTA became effective in 1985. From 1986 to 1987, U.S. exports to Israel increased 18 percent, and by another 17 percent in 1988. U.S. investment in Israel also has expanded. Numerous companies have established or expanded existing manufacturing operations in Israel to take advantage of the FTA with the United States, as well as the FTA that Israel has with the European Community.

Bilateral free trade arrangements complement the multilateral trade liberalization effort. FTA's are not designed to nor do they have the effect of replacing the GATT system. They can, however, act to spur needed changes in the multilateral trading system.

It cannot be said that either the U.S.-Israel Free Trade Arrangement or the U.S.-Canada agreement has weakened the GATT system. Indeed, I firmly believe that they have encouraged the multilateral system to reach for higher, improved levels of trade liberalization. They have also provided very significant political benefits to the United States, by signaling to the rest of the world that we will not allow the dialogue in international trade negotiations to be dictated by the lowest common denominator, that we will re-exert our leadership in the GATT and elsewhere through the example of liberalized bilateral trade, and that we welcome the challenge of trading with any country openly and fairly on the basis of reciprocal market access.

The U.S. economy is the largest, most open economy in the world. Therefore, the relative cost to the United States of reducing tariffs and nontariff barriers as part of an FTA are small. In contrast, the benefits are considerable.

First, since FTA's are reciprocal, other countries are required to eliminate tariff and nontariff barriers that generally are much higher in their country than they are in the U.S.

Second, since the tariff and nontariff barrier reductions negotiated under an FTA are only available to the countries participating in the negotiations, the United States will enjoy a margin of preference for its exports to FTA countries. This will mean that our negotiators will not be liberalizing, as they have been, international trade for the benefit of exporters in Asia and in other European competing countries.

I am very supportive of the United States negotiating FTA's, and in particular with our trading partners in the Pacific Rim. The countries of the Pacific Rim have experienced extraordinary real growth recently, growth that bodes well for increasing U.S. exports.

In addition, the countries in this region are economically stable, there is no fear of hyper-inflation, they are well able to service their foreign debts, their infrastructures are well developed, their labor forces are literate, skilled, and inexpensive compared to the United States. And in fact, a number of countries in the region have expressed an interest in seriously exploring an FTA with the United States.

Finally, the full integration of the European economy slated for 1992 offers us a challenge to expand our vision and our economic borders across the Pacific.

FTA's demonstrate the real benefits provided by increased trade liberalization. This in itself is a significant benefit. In addition, the 1988 Trade Act sent a message to the international trade community: the United States will exercise the leverage of access to our considerable market to open markets overseas. That negative message, however politically or economically necessary, has caused a growing number of our trading partners to question our leadership in the multilateral system as well as our commitment to free trade.

I would like to suggest this morning that offering these trading partners an additional incentive in the form of the negotiation of an FTA would make very clear that we are not afraid of fair competition, and it would allow the United States to provide positive, forward-looking leadership to the rest of the world.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Mrs. Cooper, very much.

[The prepared statement of Mrs. Cooper appears in the appendix.]

Senator BAUCUS. Mr. Aho?

STATEMENT OF C. MICHAEL AHO, DIRECTOR OF ECONOMIC STUDIES, COUNCIL ON FOREIGN RELATIONS, NEW YORK, NY

Mr. AHO. Mr. Chairman, it is a pleasure to be here to discuss bilateral trade agreements and whether the historic agreement with Canada can or should be replicated elsewhere, in particular with Japan.

And Doral is correct: we probably will disagree fairly substantially this morning.

In the past I have probably been fairly critical of the Reagan administration on trade policy, and of course the administration has now passed into history; but that administration does deserve credit for negotiating the pact with Canada, because it did signal that trade liberalization is still possible, and that international negotiations can still bear fruit.

The Canadian pact has gone further faster than the multilateral GATT talks and could be a catalyst for those talks. The agreement was comprehensive, spanning virtually the entire GATT agenda.

However, before replicating that historic bilateral agreement, the U.S. should stand back and take stock of the agreement. It is a complex agreement that was complicated to negotiate, despite the vast similarities in both countries' legal and business environments. The signing of the agreement was not meant to be the end of the process, but only the beginning. And what happens next? Several questions arise.

How durable will the agreement be? That, of course, will depend upon the first major tests of the dispute settlement apparatus, or possibly on the pressures for protection emanating from an economic downturn.

How will the agreement evolve? How and when will the blanks be filled in, for example on specific service sectors or on developing common laws on subsidies?

Can serious negotiations on subsidies begin before the conclusion of the Uruguay Round, or will one country or both prefer to wait until the Round is completed?

Specifically, how will the bilateral blend with the multilateral talks, and will Canada seek to recontract if the United States extends similar privileges to other countries during the Round?

How will both countries behave in response to changing circumstances—say, generated by Europe 1992, or by the prolonged disagreement over agricultural issues? A common position may be possible on Europe 1992, but will the United States and Canada share a common interest in cutting a deal with the Community on agriculture?

What about third-country issues? The most significant third country, of course, is Mexico. The United States and Mexico have established a framework agreement, and now there is talk of sectoral agreements. But Canadian and Mexican exports to the United States overlap significantly in autos and auto parts, energy, petrochemicals, and agriculture. I am sure that if the United States and Mexico were to sign a trade agreement in auto parts, Canada would want to have something to say about it.

The U.S.-Canadian agreement is a good agreement, but it did not address many of the central trade difficulties between the two countries, including subsidies, trade remedy actions, government procurement, and intellectual property. It took almost 2 years to negotiate, and the talks came perilously close to collapse on several occasions.

Before launching another bilateral, would it not be better to wait to see how this one works out? Furthermore, additional bilaterals may create more problems than they solve.

Fred Bergsten and Jeff Schott have covered many of the economic arguments against additional bilateral agreements, and more are in my statement.

Leaving aside those economic arguments, however, let me focus on the political arguments against additional bilateral agreements.

Internationally, the essence of a bilateral agreement is that you play favorites, and this creates foreign policy problems with those that are discriminated against. If pursued, a misguided bilateral strategy could even end up altering the political contours of the Alliance.

But domestic political problems are also caused. Congress will be under pressure to withdraw trade preferences or withhold further liberalization if countries are deemed to be acting inconsistently with U.S. foreign policy objectives, or if important domestic sectors are suffering from increased competition with the country involved.

Do Members of Congress want to get involved in such micromanagement of trade and foreign policy initiatives? Does Congress have the time, resources, or political will to review, oversee, and legislate a series of bilaterals with all of the attendant political pressures they entail?

To elaborate further on the practical and tactical problems with additional bilaterals, consider a possible U.S.-Japanese free trade bilateral agreement.

One of the reasons cited for pursuing a bilateral accord with Japan—and it has been brought up this morning—is the EC's effort to establish a Europe without borders by the end of 1992.

The assumption is that the EC will discriminate against outside interests as it liberalizes internally. I agree. If we don't pay attention, the European Community probably will discriminate against us. Advocacy of the bilateral trade agreement may be useful as a threat, however, now is not the time to begin exploring bilateral options with Japan. The external consequences of 1992 have not been debated or even discovered by the Community as yet.

Now is the time for other governments and firms to put pressure on the Community to open up the process to comments and criticisms. If we wait too long, however, the Community's position will be set in concrete, leaving little room for them to negotiate at the Uruguay Round or elsewhere.

I would make the Europe 1992 exercise a focal point at the Uruguay Round, to ensure or to try to ensure that the rest of the world is not discriminated against.

This however raises a further problem, when it comes to bilateral agreements, and this is really the question of flexibility. If the United States and Japan were to go out and strike a bilateral deal, that might help us in keeping the Community open after 1992; but for all the reasons we have been discussing concerning market access problems with Japan this morning, I am not certain that the United States and the EC might not form a coalition at some point in the multilateral talks and focus solely on opening that Japanese market.

Coalitions will shift from issue to issue, and I think the United States would lose that flexibility if it were to marry up with another particularly large pillar of the trading system.

Frankly, I don't know, between the United States and the EC, or maybe some of the other countries that Doral was mentioning, who is the most appropriate partner, and who decides and how do we decide. I think we would sacrifice some flexibility.

If I might be permitted an advertisement for you and for myself, we do have back-to-back articles in the forthcoming Cornell International Law Journal, and the pros and cons of additional bilaterals are laid out in my article which I have included for the record.

Let me jump to a concluding comment, if I may.

First, on Canada itself, I think we need to pay more attention to the Canadian Agreement, because if it begins to look like that agreement is failing, others are going to take notice. If we ignore the Canadian Agreement we will lose the credibility of our bilateral option, and others will be able to say, "Hey, look, the U.S. and Canada couldn't even cut a deal in some of these sectors; so why should we go out and do anything multilaterally?"

But let me conclude with a more general comment about the importance of a threat as far as bilateral agreements are concerned.

I would say the United States should stick to the multilateral process and, if that flags, should stick it to other countries unilaterally in order to prod progress. Bilateral agreements may be useful as a threat, but to be credible the administration and Congress must be willing to carry out that threat.

The only other possible bilateral trade agreement that is clearly in the U.S. long-run interest is one with Mexico, for reasons that range from debt to demography to drugs. If the administration is serious about threatening further bilaterals, it should continue to explore those bilateral options with Mexico, because to move beyond Mexico would create significant foreign policy problems.

Push hard on the multilateral negotiations, and use Mexico as a credible threat. Besides, could the United States really contemplate giving preferential access to other major trading partners while denying it to Mexico?

Thank you.

Senator BAUCUS. Thank you, Mr. Aho.

[Mr. Aho's prepared statement appears in the appendix.]

Senator BAUCUS. That leads into you, Mr. Erb.

STATEMENT OF GUY F. ERB, DIRECTOR, U.S. COUNCIL OF THE MEXICO-U.S. BUSINESS COMMITTEE, AND MANAGING DIRECTOR, ERB & MADIAN, INC., WASHINGTON, DC

Mr. ERB. Thank you, Mr. Chairman.

My name is Guy Erb. I am a managing director of Erb and Madian, and the director of the U.S. Council of the Mexico-U.S. Business Committee. It is a pleasure to share my personal thoughts with you this morning on the Mexico-U.S. Bilateral Agreement.

In 1987 Mexico and the United States signed that agreement on bilateral trade and investment. The agreement became possible as a result of changes in the composition of bilateral trade, a very important Mexican shift toward outward-looking development policies, and increasing business and government awareness of the benefits of a more certain framework for an important bilateral trade relationship.

It is a modest agreement; nevertheless, it is a major innovation for the two countries. We can now build on that agreement, but we can also go beyond it.

I will be mentioning some options for future trade and investment negotiations this morning with you.

Let us look backwards, if we may, for a moment. At the time of the agreement signature, it had been a period of over 40 years since the United States and Mexico had had a consultation mechanism on trade.

In spite of the very tight trade links between the two countries, indeed commercial links of all sorts, they had managed an increasingly complicated relationship without a formal mechanism for consultation.

However, in the aftermath of the debt crisis of the early eighties and the sweeping changes that became obvious as needed for the Mexican economy, then-President Miguel de la Madrid of Mexico announced significant trade reforms in early 1985.

By 1986 Mexico had resolved its dispute with the United States on subsidies and countervailing duties, had joined the GATT, and we opened negotiations on the bilateral agreement. That agreement, as you know, is now with us for over a year, and it has led to some significant accomplishments.

In the context of the Mexican reforms that are taking place even as we discuss this morning, it is important to note that support for the old regime in Mexico lingers. But I am convinced that President Carlos Salinas is determined to continue the modernization of the Mexican economy.

We can therefore expect, in whatever framework is finally chosen, negotiations on trade, debt, and investment with an increasingly growth-oriented and modern country on our Southern border.

Another important aspect of this whole process was the strong business and government support for the formation of the agreement. That is in sharp contrast to the period in the 1970's, when

Mexico's tentative move toward GATT membership in 1978 and 1979 lacked domestic support, lacked a business constituency.

As a result of its reforms, Mexico's highest tariff is now only 20 percent, and only about 20 percent of its imports require import licenses—historically a very low ratio for Mexico.

However, views in the United States of Mexican economic and trade policy have not kept pace with the changes that country has introduced. We often encounter here business and political attitudes that are based on prior experiences with Mexico's relatively closed economy. We have to change, "catch up," as it were, with events in Mexico.

For their part, Mexicans are also skeptical of the United States. Although we have not always implemented obstacles to Mexican exports, those cases that did occur, and even the discussion of cases where we might have imposed barriers to Mexican exports, have convinced many in Mexico that they face a hostile market in the United States. That is a view with which I do not agree, but it is a perception in Mexico.

The attachment to my testimony chronicles the major events that led to the bilateral agreement. It took 6 or 7 years of effort from the initial discussions to the final signature.

Attachment 2 to my written statement is the agreement itself. First are the principles which earlier speakers, in the panel before us, have mentioned as a possible model for other agreements. That statement of principles may seem like motherhood, Mr. Chairman, but we have to bear in mind the lack of common ground that existed in the past between the United States and Mexico.

The importance of these principles are that they are a shared starting point for an important commercial relationship, a starting point that we lacked in the past. They fall into categories such as the general and economic and political goals of the two countries, the unique nature of the bilateral relationship and the interest that both countries have in it, and principals on key issues such as services, intellectual property, border development, and private investment.

Very importantly, the agreement also sets out procedures for consultation and dispute settlement, including a timetable, and an agreement to seek settlement through the GATT if either country feels that is desirable.

Also an important feature of this is either one of the parties can seek consultations at any time.

The negotiators, at the time they did the agreement, established an immediate-action agenda, which did indeed lead to negotiations in such important areas as steel, textiles, and broad liberalization of Mexican barriers.

What are the options to continue the process that has been begun with the framework agreement? We could, of course, continue to implement it, which is a worthy but not very ambitious objective.

Some in Mexico have proposed as an option the expansion of U.S. trade preferences or tariff preferences for Mexico, in order to recognize the very significant unilateral reforms and liberalization that Mexico has undertaken. This idea, for reasons which I discuss in more detail in the written statement, has little political appeal here in the United States.

Another option which Mike Aho mentioned is the sectoral approach. Indeed, in 1989 Mexico and the United States are expected to commence these negotiations, but they face problems of their own, not the least of which is the Canadian historical experience with such an approach.

Another means is a more ambitious comprehensive trade and investment negotiation, which would seek through staged concessions the full liberalization or the liberalization of substantially all bilateral commerce.

We would look for, here, a staging asymmetrically, so that the United States would recognize the vast differences that went into the United States and offer concessions on a more accelerated timetable, in the context of shared commitments toward that final objective.

I might mention here that the Spanish accession to the European Community is an example of an exchange of mutual commitments to stage concessions between unequal partners.

Just to conclude, Mr. Chairman, I think that the sectoral approach and the comprehensive approach do merge at some point, if you recognize—as happened in the case of Spain and the European Community—that particular sectors will be on their own timetable for liberalization, and we can easily envisage that process in Mexico and the United States.

Finally, if you seek an objective which is fully compatible with the GATT and with the free trade area, I think we have met some of Senator Danforth's concerns on the subject of the special relationship and its possible impact on trade policy.

There is no question, as Mr. Aho has mentioned, that we do have very serious non-trade interests in Mexico. But if we put our trade objectives on the solid footing of a mutual commitment to eliminate trade barriers, over whatever length of time is necessary, I think we have met what could otherwise be a serious concern.

Thank you.

Senator BAUCUS. Thank you very much, Mr. Erb.

[The prepared statement of Mr. Erb appears in the appendix.]

Senator BAUCUS. What about Mr. Danforth's point, Mrs. Cooper, that bilateral agreements are a trap? That is, we have faced them somewhat—to paraphrase his argument—on "special relationships," and once we get close to reaching an agreement we feel that, you know, for political and other reasons, we have to reach a conclusion, which often tends to be detrimental to the United States' best interests. That is a very real concern of his. What do you say in response to that point?

Mrs. COOPER. Mr. Chairman, the relationship that the United States has with every major trading country is special. True, Israel is special, Canada is special, Mexico is special, Taiwan is special, Singapore is special—Korea, Japan. Each country is special. So I don't think that we have necessarily begun or finished FTA's with only those countries which are special.

That is why the fear about not wanting to leave the table until you sign an agreement, I think, is in part taken care of through the separation of powers. We have the Congress, which will review the agreement, as it did in the Tokyo Round, as it will in the Uruguay Round, certainly as it did in an extraordinarily detailed fashion for the Israel and Canada FTA's. And I think we have that check in order to ensure that the United States is not selling out to the foreign interests in a negotiation.

No one ever wants to step away from a negotiating table, whether it is in an FTA or whether it is in the Uruguay Round. But I think the checks-and-balances process, thus far in the history of trade negotiations of this country, has ensured that each agreement was as fair and as equitable to the citizens of this country as possible.

Senator BAUCUS. You heard Mr. Bergsten say that the Canadian FTA was probably a good agreement, but that Japan is different. I mean, Japan is not our neighbor; Japan has an economy that is much larger than ours, has a different culture. It is so different that you can't compare the free trade agreement with Israel or with Canada along with that of Japan.

What is your response?

Mrs. COOPER. Two things. First of all, as an old trade negotiator, it is much harder to negotiate with your friends than with people who are not like you. You can ask anyone in this room who has ever negotiated with Canada, for instance, that those are the toughest and most acrimonious negotiations that we have ever had. So, I don't think it is necessarily easier to negotiate with your neighbors; indeed it is much more difficult.

Second, nowhere in the GATT history does the GATT say that FTA's should only be negotiated with neighboring countries. That was never envisaged when article XXIV was drafted, and in fact I would say that some successful FTA's are in place with non-neighboring countries. So, I see no reason to not consider seriously negotiations with our Pacific Rim countries. And in the Pacific Rim, I do indeed include Mexico.

Senator BAUCUS. What about his point—he didn't quite say this, but maybe it was implied—that the United States and the Canadian economies are somewhat similar, we have similar background, culture, et cetera, but with Japan we are dealing not very much with formal trade barriers, although we are in some cases, but in many cases with non-formal trade barriers—namely, Japan's distribution network?

You know, the classic FTA can make sense when you are dealing with a culture and a society that is similar, but not in trying to somehow reform the Japanese distribution system.

Mrs. COOPER. It is easier to negotiate tariffs in free trade arrangements than it is nontariff barriers; there is no doubt about that. And the more difficult nontariff barriers are indeed things that you can't touch, like the distribution system in Japan.

If I may offer a suggestion for the Pacific Rim trade initiative which is slightly different than yours, Senator: that we consider negotiating FTA's with those countries in the Pacific Rim which have tariff barriers in place—easy ones to negotiate—and that are neighboring countries of Japan, and that we consider negotiating an FTA with Japan last rather than first, thereby increasing our negotiating leverage on the Japanese distribution system considerably.

Senator BAUCUS. While I am talking with you, Mr. Aho said—I don't want to put words in his mouth, but I think this is what he was saying—that while maybe the Canadian FTA was probably okay, there are sure a lot of blanks to be filled in yet, so the jury is out. I take it you agree that the Canadian FTA was a good idea. Would you share with us your concerns about the blanks?

Mrs. COOPER. Yes, there are a number of blanks. I think probably the most crucial one will be when we have a serious dispute with Canada. That is inevitable.

Let me just share my experience with Israel, since our history with that agreement obviously is much longer. The U.S. Government has had a number of serious disputes with Israel, but we found that the fact that there was an FTA in place, coupled with the threat of calling a panel in the dispute settlement process, has helped the U.S. Government to resolve those disputes much more expeditiously than would have been the case had the FTA not been in place.

Senator BAUCUS. Mr. Aho also said that the bilateral had the unfortunate result of playing favorites, to the detriment of our relations with other countries. What about that?

Mrs. COOPER. Well, don't say "favorites." Put an FTA on the table and let any country sign on that wants to, a non-discriminatory FTA.

Senator BAUCUS. Mr. Aho, that is your opening. What about that?

Mr. AHO. Well, one, I am not sure, despite all of the old negotiators in this room, that we have enough of them in this country to be able to conduct a number of these things simultaneously. They turn out to be somewhat inconsistent with one another, and it would set up an entirely different and separate operation from the multilateral talks. So I think it would divert, if nothing else, an awful lot of attention from the Uruguay Round.

But in thinking about a negotiation along the Pacific Rim or with Japan, specifically, consider the concessionary nature of negotiations. And with Japan in particular, what is the United States "going to give up"? Our voluntary export restraints in autos and steel and machine tools, and things like that? We know what we might like to get from the Japanese, but these are very tough political things that we are going to be asking of them; what are they going to ask of us? And are we going to be willing to take that step?

Senator BAUCUS. Well, they are asking us basically to reduce our federal budget deficit. That is one big request of theirs. I think you would agree we should do that.

Mr. AHO. I definitely agree we should do that.

Senator BAUCUS. Mr. Erb? You had your hand up.

Mr. ERB. Not on that point, Senator. I did want to make a statement on the time involved, prompted by what Mike said about the necessity to have a team, and by Doral's remarks about putting a draft FTA on the table and saying anybody who wants to sign it can do so.

First, on the question of time, just as I proposed that time is the solution to some of the disparities that exist between Mexico and the United States from their point of view, and some of our concerns about competition towards sensitive sectors here, it should be noted that it does take time to do these things.

The Canadian agreement perhaps is underestimated, that the two years that it took really was the end of a long process, which included 20 years ago the automotive agreement—more than 20 years ago—and then an attempt by Canada through much of the late seventies and early eighties to pursue an entirely different option, which was the sectoral approach. The 2-year process was the peak, on top of a rather long and arduous mountain that had to be climbed.

In the case of Spain and the Community, it took 23 years from the moment of the first Spanish application to the signature on an agreement to accede to the Community, and it will take another 10 years, from 1985, for them to be a full member of the Community.

In each of these negotiations—whether it is Israel, Canada, or Spain and the Community—peculiar characteristics of each country and each trading relationship have to be taken into account.

Therefore, I do doubt that drafting an all-purpose generic FTA and saying, "Sign here, just fill in the blanks," would work. I mean, each country is going to bring to the table——

Senator BAUCUS. How about a regional one?

Mr. ERB. Well, even more so, Senator, because each country has its own "coruzonsito," as they say in Mexico—you know, its own thing that is very special to them. We have steel and textiles and automotive. Mexico has a very backward agricultural sector that will need to be addressed, which is paralleled by a very aggressive and competitive agricultural sector.

So, we have to find a way to ease the pain on our side of Mexican exports, and to ease the difficulties that they will have of bringing their agricultural sector, broadly defined, into full competitiveness on the world standard.

So, I really think that each case will require a very long and arduous negotiation. I would argue, as well, that propinquity, the "three D's" that Michael mentioned as well as some other more positive aspects of the relationship, justify a careful look at that particular bilateral—not to the exclusion of others, but I would hope with a sense of priority that relates to some of the particular aspects of the interrelationship between the United States and Mexican economies.

Senator BAUCUS. I was wondering, Mr. Aho, when, in your judgment, do bilaterals—however you define them—make sense in the future?

Mr. AHO. Well, I guess we would have to postulate. If a failure of the Uruguay Round were be one of the things that led us in that direction, then I would prefer a Pacific Rim agreement, a preferential agreement along the whole Rim, as opposed to picking and choosing among countries.

But if you are going to go with a country for the reasons of a threat, or whatever, I would go with the long-term interest that we have in doing one with Mexico.

But in the wake of a failed Uruguay Round, I would try to do something along the Pacific Rim. However we are far away from that at this stage.

Senator **Baucus**. What about Mr. Erb's point that it takes forever to conclude these things; so you might as well begin now?

Mr. **Aho**. But if you begin now, how can we ensure how that will change the behavior of other countries? Read here the European Community. Will they find it in their interest to go out and start negotiating some of their own bilaterals? Will it bring them to the table, or will it force them away from the table? That is difficult to judge at this stage.

And also like Fred, traveling around the world I get the sense that the Community would probably—and they are very good at it—start cutting their own preferential deals and move away from us, and not towards us.

Senator **Baucus**. Mrs. Cooper?

Mrs. **Cooper**. Senator, if I may clarify one earlier remark for the record, when I suggested putting an FTA on the table, I suggested the concept of an FTA. Of course, each and every one would have to be negotiated separately, because the economies obviously are very different. and the phase-in periods would be very different.

Mr. **Aho**. I thought that was what you meant.

Mrs. **Cooper**. Thank you.

Senator **Baucus**. Does anybody have anything to say in response to something that someone said that you found "outrageous" or that "got under your skin" before we wrap up here? Or do any of you have any final points you want to make? [Laughter.]

Mr. **Erb**. A final point, Senator. I do applaud you for commencing this debate. I think that it is one of the critical issues that U.S. trade policy must address.

I think I would emphasize the Uruguay Round, recognizing, as the earlier panel pointed out, as well, that all trade negotiations take time.

In the trough of one particular negotiation, as we seem to be now, it looks darkest perhaps before the dawn, and I certainly am not ready to write off the Uruguay Round as a valid and priority negotiating option for the United States; nor would I suggest that the introduction of a bilateral negotiation with Mexico should in any way derail the attention that the Uruguay Round deserves.

Senator **Baucus**. On that point, though, how do we exercise leverage, given the current multilateral framework, to get a successful Uruguay Round on agriculture, intellectual properties, services, and so forth? what is our leverage? Remember we have much less leverage now than we did 20 to 30 years ago.

Mr. **Erb**. We still have an enormous market and countries all over the world that desire access to that market. As we have seen in trade disputes with the Community, that is a respectable point of leverage.

Senator **Baucus**. But is it a credible threat?

Mr. **Erb**. Oh, I think so.

Senator **Baucus**. Because this country is not very likely to implement quotas or tariffs.

Mr. **Erb**. Well, a very large proportion of our trade is now under quantitative restraints.

Senator **Baucus**. No, I am talking about additional.

Mr. **Erb**. Well, I wouldn't rule it out. I have watched over the past 25 years increasing limits on executive branch discretion, increasing use by both the Executive and at the instigation of the Congress of quantitative restraints, and the Super 301 is another example.

Senator BAUCUS. So you suggest using Super 301 as a potential, and 301 generally as a potential threat?

Mr. ERB. Certainly the threat is credible, and I think other countries are very concerned about that.

Senator BAUCUS. I agree with that. We probably do have to use it, or at least be ready to use it if we have to.

Mrs. Cooper?

Mrs. COOPER. Senator, like Mr. Erb, I applaud your initiative in stimulating the debate on this subject. I think the fact that the Congress of the United States is seriously considering the idea of FTA's with other countries in the Pacific Rim, in particular, sends a warning to our trading partners but likewise creates an opportunity for our trading partners.

I think the discussion will, if nothing else, increase the leverage on the Europeans as they start to think about 1992. I do not think the debate on free trade areas in any way diminishes our will and our negotiating goals in the Uruguay Round.

And finally, I would like to reiterate a point that was made earlier by others. The trade law does send a message to our trading partners that is quite aggressive. I think the notion of discussing at the same time the opportunities that we can afford our trading partners with free trade area negotiations balances that message that we are sending the rest of the world.

Thank you.

Senator BAUCUS. Thank you.

Mr. Aho?

Mr. AHO. Yes. I, too, applaud your putting these questions on the table, because we have got to have at least the thought process going on in order to challenge the people overseas.

But I would come back to the point that I had made earlier about shifting coalitions. I think, from issue to issue, it will vary. And I saw, in the launch of the Uruguay round at Punta del Este, the importance of the Cairns group on agriculture which, in prodding that process, helped. And I think if we move and select other countries to prod the Europeans in some cases, or the Japanese in others, we can probably move that process forward.

But I wouldn't leave out one other form of flexibility, and that is what we did in the Tokyo Round, with conditional most-favored-nation agreements. If we want something on services and there are foot-draggers like Brazil or India out there, don't deal them in. Don't go for the lowest common denominator. Just set up a like-minded group who want stronger disciplinary action on services, or investment, or intellectual property. That gives you the flexibility. And I think the countries that will buy into those individual agreements will vary from issue to issue.

Senator BAUCUS. Thank you all very much.

What all this comes down to, as I see it, is leadership in this country and in Pacific Rim countries, and all major countries of the world, for that matter.

It is a real challenge, and the proof is in the pudding as to whether we and other countries meet that challenge. I hope we do, and certainly your discussion here today will give us more information to enable us to do so.

With that, I want to thank you very much for coming. I appreciate it.

Mrs. COOPER. Thank you.

Mr. AHO. Thank you.

Mr. ERB. Thank you.

Senator BAUCUS. The hearing is adjourned.

[Whereupon, at 11:45 a.m., the hearing was concluded.]

APPENDIX

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

PREPARED STATEMENT OF C. MICHAEL AHO

Mr. Chairman and members of the committee, it is a pleasure to be here to discuss bilateral trade agreements and whether the historic agreement with Canada can or should be replicated elsewhere, in particular with Japan. In the course of this statement I will also comment upon the state of the multilateral talks in the Uruguay Round, Europe 1992 and possible U.S. policy responses to the European unification effort.

Several proposals for other bilateral trade agreements have come on the heels of the Reagan administration's negotiation of the bilateral agreement with Canada, our largest trading partner. (A less comprehensive agreement was negotiated with Israel in 1985.) The Reagan administration deserves credit for successfully negotiating the pact with Canada, because it did signal that trade liberalization is still possible and that international negotiations can still bear fruit. The Canadian pact has gone further, faster than the multilateral GATT talks and could be a catalyst for those talks. The agreement was comprehensive, spanning virtually the entire GATT agenda, including most of the new issues, services and investment, but not intellectual property. However, additional bilaterals could result in increased trade frictions and could eventually fragment the trading system.

THE FUTURE OF THE U.S.-CANADIAN AGREEMENT

Before replicating the historic bilateral free trade agreement with Canada, the U.S. should stand back and take stock of that agreement. It is a complex, comprehensive agreement that was complicated to negotiate despite the vast similarities in both countries' legal and business environments. The signing of the agreement was not the end of the process, only the beginning. What happens next? Several questions arise.

How durable will the agreement be? That will depend upon the first major tests of the dispute settlement process or possibly on the pressures for protection emanating from an economic downturn. How will the agreement evolve? How and when will the blanks be filled in, for example, on specific service sectors and on developing common laws on subsidies? Can serious negotiations on subsidies begin before the conclusion of the Uruguay Round or will one country or both prefer to wait until the Uruguay Round is completed? Specifically, how will the bilateral blend with the multilateral talks and will Canada seek to recontract if the U.S. extends similar privileges to other countries during the Uruguay Round? How will both countries behave in response to changing circumstances say generated by Europe 1992 or by prolonged disagreement over agriculture trade? A common position may be possible on Europe 1992 but will the U.S. and Canada share a common interest in cutting a deal with the Community on agriculture?

What about third-country issues? The most significant third country is Mexico. The U.S. and Mexico have established a framework agreement and now there is talk of sectoral agreements. But Canadian and Mexican exports to the U.S. overlap significantly in autos and auto parts, energy, petrochemicals and agriculture. If the U.S. and Mexico were to sign an agreement in trade in auto parts, I am certain Canada would want to have something to say about it. There will be no escaping these issues when the U.S. and Mexico ultimately sit don to negotiate.

The U.S.-Canadian agreement is a good agreement, but it did not address many of the central difficulties of trade between them including subsidies, trade remedy actions, government procurement, and intellectual property. That agreement took almost two years to negotiate and the talks came perilously close to collapse on several occasions. Before launching another bilateral, would it not be better to wait to see how this one works out? Furthermore, additional bilaterals may create more problems than they resolve.

GENERIC PROBLEMS WITH BILATERAL FREE TRADE AGREEMENTS

Bilateral free trade agreements are justified only in special cases. Israel, for political reasons, and Canada, for reasons of proximity and interdependence, are special cases. The EC is also a special case on the latter score. President Reagan in his 1988 State of the Union address spoke of including Mexico in a North American accord. Mexico may also be a special case, but after that it is hard to see other countries or the private sector in the U.S. going along with any other bilateral agreements.

To put it bluntly, a succession of bilateral trade agreements is a recipe for RIBS—resentment, inefficiency, bureaucracy and silly signals. Resentment would prevail among outsiders. Inefficiency would be spawned by the fragmentation of markets. Bureaucratic nightmares would result for the government and private firms trying to cope with the discrimination among countries. And silly or stupid signals would be sent to those policymakers in developing countries who are proponents of markets and multilateralism. Lastly, other countries would protest if the U.S. tried to go beyond these special cases. After Canada, Israel and maybe Mexico sometime in the next century, the options are, or should be, spent.

History can be instructive on bilateral trade agreements and a number of lessons can be learned from the 1930s. In the wake of the Smoot-Hawley tariff and subsequent retaliation, many countries tried to establish bilateral or regional agreements. But a proliferation of bilateral agreements is inconsistent with an expanding trading system. Attempts in the interwar years to establish some predictability for trade, largely through discriminatory bilateral agreements, failed because the kind of certainty gained was illusory: the conclusion of the second or third discriminatory bilateral agreement necessarily disappoints expectations created by the first. Frictions, if not downright hostility, are bound to arise between the parties. Furthermore, if other countries were to follow the U.S. lead by trying to negotiate through bilateral agreements offering mutually incompatible privileges, predictability and stability would be destroyed for all countries.

Discriminatory bilateral agreements cannot combine to form a globally consistent, stable system of national trade policies. And bilateral or like-minded groupings are inferior alternatives when compared with multilateral liberalization on a nondiscriminatory basis. Inevitably, some countries will be left out. How will they be chosen and who will decide? In this country, Congress will have to play a role. Consider how members of Congress will be whipsawed by country interests and, disaggregating further, by sectoral interests. Legislative action on separate agreements also opens up the possibility that trade will be used as a weapon of foreign policy against countries that are not following in lockstep on recent foreign policy initiatives of the United States. How will domestic trade laws be interpreted or revised vis-a-vis non-members? Some legislators, pressed by special interests, may seek to discriminate in the application of domestic law. All of this would raise trade policy from "low-level" to "high-level" foreign policy. The Secretary of State would end up spending more time on the balance of trade, leaving him less time to spend on the balance of terror. That would be a gross misallocation of resources.

Bilateral or like-minded agreements also will smack of colonialism to left-of-center politicians in many developing countries. Even for countries given preferential treatment, such an arrangement would add fuel to domestic political battles to say nothing of the domestic political battles in countries discriminated against.

The United States, Japan and the EC, the major pillars of the trading system, cannot afford to be in rival blocs. Although, the U.S. has expressed some frustration with the EC for slowing the multilateral process and with Japan over market access, Western cooperation remains important for strategic and security reasons and must not be undermined. The best message of Alliance cohesion the Western nations can send to the Eastern bloc is a flourishing, unified, nondiscriminatory trading system. A fragmented system would send precisely the wrong signal.

In short, the arguments against a series of bilaterals are both political and economic. Politically, the essence of bilaterals is that you play favorites and that creates foreign policy problems with those that are discriminated against. If pursued, a misguided bilateral strategy could alter the political contours of the Alliance. Domestic political problems are also created. Congress will be under pressure to withdraw trade preferences or withhold further liberalization if countries are deemed to be acting inconsistently with U.S. foreign policy objectives or if important domestic sectors are suffering increased competition from the country involved. Do members of Congress want to get involved in such micromanagement of trade and foreign policy initiatives? Does Congress have the time, resources or political will to review, oversee and legislate a series of bilaterals with all of the attendant political pressures that they entail?

Finally, the economic argument is that if the trading system should fragment as a result of a misguided bilateral strategy how will the U.S. be able to generate trade surpluses of up to $50 billion to service its trillion dollar foreign debt in the 1990s? Without an open multilateral trading system, that will be next to impossible. In order to appreciate the drawbacks of additional bilateral agreements, it is instructive to examine a possible bilateral agreement with Japan.

A BILATERAL TRADE AGREEMENT WITH JAPAN?

Proponents of a bilateral trade agreement with Japan cite the corrosive effect that bilateral disputes have had on the U.S.-Japan relationship and the ineffectiveness of the piecemeal approach to solving disputes. But without internal reforms of the trade policy process in the U.S. to establish priorities and to give trade issues the greater attention they deserve, it is hard to see how a bilateral with Japan would overcome these difficulties. And why should the U.S. assume that on the contentious issues (e.g. agriculture, construction, etc.), Japan would be any more able or willing to accede to American demands in a negotiation to establish a bilateral agreement? Multilateral pressure would be more effective and more palatable politically within Japan. Furthermore, if somehow the U.S. succeeded in resolving festering disputes with Japan, the principle of unintended consequences would surely come into play and one set of problems would be replaced by another as those countries discriminated against take policy actions to minimize the damage to them.

Another of the reasons cited for pursuing a bilateral accord with Japan is the EC's effort to establish a Europe without borders by the end of 1992. The assumption is that the EC will discriminate against outside interests as it liberalizes internally. But why isn't a unified, thriving EC in the U.S. interest as it was thirty years ago? It is! If these reforms are carried out, European national income could rise by 5–7 percent and up to 5 million new European jobs could be created. Europe would be richer and could afford to buy more from the rest of the world and pay more for the Alliance's common defense.

What if it were to fail, and, worse yet, what if the U.S. was seen to be part of the blame? The price of failure would be very high. The frustrated expectations would sour European attitudes toward the United States. In a backlash, trade protectionism would increase. Little if anything would be accomplished in the Uruguay Round of multilateral trade talks. A weaker Europe would be less willing and less able to bear its share of the burden for the common defense. And it would play into the hands of the Eastern bloc, as more Community policymakers would turn East for markets and support.

That isn't to say there is nothing to be concerned about. Watch out to see if Community directives call for a narrow application of reciprocity and establish European preferences to discriminate against outsiders; if the directives provide long phase-in times and safeguards for lagging sectors or for the poorer European countries; who negotiates regulatory standards for the Community, and on what basis outsiders can get mutual recognition of standards; if the multilateral talks are held hostage to the internal restructuring; how bilateral quotas on cars and textiles at the national level are converted to EC-wide quotas, and whether the directives are produced in a transparent way or behind closed doors with maximum uncertainty which would have the same effect on firms outside as an increase in trade barriers.

Advocacy of a bilateral trade agreement may be useful as a threat, but if it were carried out, the trading system would fragment and all nations would suffer. Now is not the time to begin exploring bilateral options with Japan. The external consequences of 1992 have not been fully debated or even discovered by the Community as yet. Now is the time for other governments and firms to put pressure on the Community to open up the process to comments and criticism. Outside interests need to be more vigilant in monitoring what is going on in Brussels because if they wait until 1992, it will be too late. The Community's position will be set in concrete, leaving no room to maneuver at the Uruguay Round or elsewhere. The 1992 internal restructuring should be made a focal point of the Uruguay Round so that the Community feels constrained when reaching internal decisions.

A bilateral trade agreement with Japan would tie the hands of American trade negotiators. The launch of the Uruguay Round at Punte del Este demonstrated the importance of coalition formation as a means for making progress. But coalitions shift from issue to issue. On market access to Japan, the U.S. might agree someday to join with the EC to gang up on Japan in a multilateral forum. But, the U.S. and

Japan may have to join together to ensure that the EC does not use the 1992 effort as a means to discriminate against outside interests. It is better to retain the flexibility to form different coalitions and to use unilateral retaliatory measures to prod the process, than to limit options by joining a bilateral with another major pillar of the trading system. And if other bilaterals are contemplated, it is not at all obvious which is the most appropriate partner, Japan or the EC. Who is going to decide and on what basis?

Granted, new options are needed in this highly pluralistic world to bring more pressure on free riders and foot draggers. The preferred approach, however, should be a conditional MFN approach as was done with the Tokyo round codes in which only those signatories to the code get the benefits from abiding by the additional discipline. Since the free riders and foot draggers will vary from issue to issue, this approach allows for greater flexibility.

Beyond these tactical issues, there are many practical reasons to reject a bilateral agreement with Japan. First, negotiation of a traditional free trade agreement covering tariffs and non-tariff barriers or even including the new issues is too modest a goal. The most difficult problems the U.S. has with Japan including the distribution system and cultural preferences are not susceptible to negotiation by formula or by drafting new rules.

Second, both countries have substantial trade interests and investments in other countries. Establishment of a free trade agreement would divert trade and investment resulting in economic inefficiencies raising consumer costs and altering sourcing patterns for firms with subsidiary operations in other countries. The extent of the net inefficiencies created would depend upon the balance between trade creation and trade diversion. Nonetheless, some consumers, affected multinational corporations and third-country business interests would find cause to complain.

Third, even the onset of negotiations would cause other countries to change behavior and not necessarily in ways conducive to reaching a multilateral agreement. Other Asian countries would clamor for similar negotiations with either or both Japan and the United States, their major trading partners. The U.S. does not have the capability of conducting a series of bilaterals simultaneously, but could it afford to defer resolution of these requests until the U.S.-Japanese negotiations are completed? Since U.S. actions are often emulated, how would America respond if the EC moves to establish bilateral agreements of its own? And what happens to the indebted countries of Latin America that depend on trade surpluses to service their debts but that would surely be harmed by the trade diversion entailed in bilateral agreements?

Fourth, what would the consequences of failure be? The costs and consequences of failure need to be compared with the likely gains from any agreement. Can the gains be so great that risking the trading system as it now stands is worth the chance? As any negotiation of this type proceeds it occurs to the negotiators that the status quo ante is not the alternative in the wake of failed negotiations. Under those circumstances, negotiators are hard pressed to come up with an agreement, no matter how good or how workable. Can we afford to take that risk?

Finally, the concessionary nature of negotiations requires that the U.S. "give up" something in the process. Will the U.S. go along with dismantling import restraints on steel, autos, semiconductors, machine tools, textiles and the other barriers that remain to Japanese exports to this country? Would Congress be willing to set up an institutional apparatus for dispute settlement that would allow frictions with Japan or other countries to skirt U.S. trade remedy laws?

A PROLIFERATION OF BILATERAL DISPUTE SETTLEMENT PROCESSES?

Apart from a wide-ranging bilateral agreement, an argument can be made for a more limited agreement covering the resolution of trade disputes. Here the experience of the U.S.-Canada free trade agreement is valuable. The U.S. and Canada established a complex institutional apparatus for resolving disputes consisting of three major parts: (1) review of antidumping and countervailing duty laws, (2) a general dispute settlement procedure and (3) the rules and dispute settlement procedures for global safeguard measures.

The provisions of the agreement spell out in some detail consultation procedures, timetables and appeal procedures but in several respects the complicated and novel dispute settlement practices are vague or remain to be flushed out. The procedures could be a substantial improvement over the existing ad hoc or GATT procedures to resolve disputes. The advantages of a bilateral dispute settlement process are (1) the external discipline over the administration of trade remedy laws, (2) the easing of trade frictions if it can be invoked easily, if it is more expeditious, and if it is abided by, and (3) reduced cost in terms of time and effort, if it is effective. These advantages have been extolled by commentators on the U.S.-Canada agreement but will it happen? How well will it work?

Consider the disadvantages of a bilateral dispute settlement process which include (1) the difficulty involved in negotiating one (the U.S.-Canada agreement could not resolve the content and operation of a dispute settlement process that could be invoked before the trade remedy law process had run its course); (2) no dispute settlement process can work effectively if the rules are ambiguous; (e.g. recent GATT cases have foundered over the interpretation of what constitutes a "fair and equitable share of the market" for agricultural goods). Ideally, a common set of domestic laws would be needed but the U.S. and Canada could not agree on what rules cover subsidies and now ongoing negotiations are needed; (3) who are the panelists going to be and how will they be chosen? Apart from the difficulty in selecting the odd-numbered panelist (panels number five), these panelists will differ from GATT panelists because they do not come from neutral third countries nor are they assisted by an unbiased international secretariat of proven competence. Furthermore, qualified panelists will likely be trade lawyers or ex-officials whose neutrality may be suspect from the point of view of one party to the complaint or another; (4) Reasonable people and experts can disagree over the shapes of supply and demand curves but it is precisely the underlying parameters of these curves (the elasticities) that will determine the effects of, say, a subsidy on the pattern of trade. Without an unbiased secretariat, whose estimates of the economic variables will be relied upon?; and (5) Depending upon how it is used, the establishment of a bilateral process could undermine the multilateral dispute settlement process just at the time it is being enhanced in the Uruguay Round.

As for the specific drawbacks of the various dispute settlement processes, the one covering antidumping and countervailing duties suffers most from the inability of the U.S. and Canada to agree on a common set of trade laws. Although negotiations will continue, the likelihood of an agreement on these issues is unlikely at least until the completion of the Uruguay Round. Many U.S. policymakers do not want to establish a precedent by altering U.S. trade remedy statutes for a single country. The other drawbacks pertain to the lack of an unbiased secretariat and the questionable neutrality of the panelists. Although panelists will be chosen from a roster of qualified people agreed upon in advance, the objectivity of panelists drawn from the two countries could always be questioned if one country or the other thought the finding was unfair. Furthermore, these panels will be established on an ad hoc basis and they will suffer from a lack of continuity and from a lack of precedent, at least until dozens of cases have been heard.

The general dispute settlement procedures are even more uncertain because only one article of the entire agreement is devoted to the creation of the U.S.-Canada Trade Commission that is supposed to administer general disputes. Article 1802 specifies that each government's "principal representative" will be the Cabinet minister for trade, allows the Commission to seek advice from nongovernmental officials and says it must meet at least once a year to decide things by consensus. This begs many questions. Just what is this Commission supposed to be? Who will its other members be? What powers will it have? Will it have a staff? Furthermore, a reading of the procedural provisions seems to indicate that general disputes will be resolved by the Commission by consensus but if the Commission is made up of the two governments' chief trade ministers, how does that differ from how disputes were resolved in the past?

Apart from meeting to review trade issues at least once annually, horn will how the Commission operate? The best that can be said is that its procedures set out provisions for an automatic, nonbinding arbitration and review of complaints (unless both sides agree to binding arbitration, but why would they both precommit?) How the Commission will interpret the various provisions of the agreement (e.g. what constitutes "nullification and impairment"?) remains to be seen. Furthermore, binding dispute settlement would be a greater external discipline over both countries but it will not have the force of domestic law. Like other international agreements, the only sanction it will carry is the right to retaliate. Beyond that, its power is derived from national traditions in observing international obligations. (Given the United States' record recently at the World Court that may not be worth very much.)

The rules and dispute settlement procedures for global safeguards provide more of a step forward because of the provisions for binding adjudication. (Because the President retains discretionary authority in safeguards cases.) But even here reasonable people and experts can disagree over the extent to which trade has caused "serious injury" depending upon the estimated economic parameters. And the provision that grants each country an exemption from the other's global safeguards when imports from the other country do not constitute an important part of the trade causing injury is a precedent for selectivity in the application of safeguard measures.

With all of these open questions, the most that can be said is that only time will tell how the U.S.-Canada dispute settlement process will work. Until it can address and process several sensitive cases, its usefulness in minimizing trade frictions can not be judged. Furthermore, even if it is an improvement over the GATT processes, those provisions are undergoing review and negotiation in the Uruguay Round and some of the presumed advantages of the bilateral dispute settlement process (automaticity and speediness) may be established on a multilateral basis. I do not believe the benefits gained from an alternative dispute settlement process justify the difficulties and the risks inherent in conducting a bilateral negotiation to establish one at this time with Japan or any other country. The proliferation of dispute settlement agreements can only cause confusion and magnify misunderstandings.

CONCLUSION

In short, given the manifold drawbacks of further bilateral deals the U.S. should stick to the multilateral process, and if that flags, should stick it to other countries unilaterally to prod progress. Bilateral agreements are useful as a threat but to be credible the administration and Congress must be willing to carry out the threat. The only other possible bilateral trade agreement that is clearly in the U.S. long-run interest (and one that the outside world, save Canada, could not object strongly to) is Mexico for reasons that range from debt to demography to drugs. If the administration is serious about threatening further bilaterals, it should continue to explore bilateral options with Mexico and weigh the costs and consequences such an agreement would entail. To move beyond Mexico would create significant foreign policy problems. Meanwhile, push hard on the multilateral negotiations and use Mexico as the credible threat. Besides, could the U.S. really contemplate giving preferential access to other major trading partners while denying it to Mexico?

Enclosure.

More Bilateral Trade Agreements Would be a Blunder: What the New President Should Do

*C. Michael Aho**

Introduction

Bilateral trade agreements, unfortunately, are once more in vogue. Frustrated with protracted negotiations under the General Agreement on Tariffs and Trade ("GATT"),[1] the Reagan Administration proposed negotiating a series of bilateral trade agreements with major U.S. trading partners. Former U.S. Ambassador to Japan Mike Mansfield and former Senate Majority Leader Robert Byrd have both suggested that the U.S. and Japan should negotiate a bilateral trade treaty. Senator Baucus promotes the idea in an accompanying Article.[2] The recently concluded United States-Canada Free Trade Agreement[3] has provided a major impetus to the advocacy of bilateral agreements, and is significant as a signal that trade liberalization is still possible and that international negotiations can still bear fruit.[4]

Proponents of bilateral accords fail to see, however, that such agreements could increase trade frictions and eventually fragment the world trade system. Beyond the unique case of Canada (and maybe Mexico sometime in the next century), further bilateral agreements are likely to produce the same disastrous effects on world trade as an overt policy of protectionism.

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[1] General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. (5), (6), T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT].

[2] *See* Baucus, *A New Trade Strategy: The Case for Bilateral Agreements*, 22 Cornell Int'l L.J. 1 (1989).

[3] United States-Canada Free Trade Agreement Communication from the President, H.R. Doc. No. 100-216, 100th Cong., 2d Sess. (1988). For a comprehensive discussion of the agreement, see International Trade—United States-Canada Free Trade Agreement, Jan. 2, 1988, *reprinted in* 27 I.L.M. 293 (1988), *and in* 29 Harv. Int'l L.J. 572 (1988).

[4] C. Aho & M. Levinson, After Reagan: Confronting the Changed World Economy 94 (1988).

22 Cornell Int'l L.J. 25 (1989)

This Article advocates continued reliance on multilateralism in United States trade policy. Part I sets the political backdrop. Part II explores the key concepts of the GATT and their vital importance in world trade. Part III explains how a move toward a trade policy favoring bilateral agreements would be a deleterious move away from the GATT. Part IV explores and rejects the most talked about potential bilateral agreement—a United States-Japan accord. Finally, in Part V, this Article proposes a strategy for President Bush that includes a strong reliance on multilateralism as the cornerstone of U.S. trade policy. Such a policy should include U.S. pressure abroad to revamp and enforce the GATT and an active presidential role in forming trade policy at home.

I. The Political Backdrop

The impetus for bilateral trade agreements grows out of substantial congressional frustration with the Reagan Administration's trade policy and with its lack of progress in solving trade problems. Despite its free trade rhetoric, U.S. trade policy fundamentally changed under the Reagan Administration toward a more tit-for-tat, protectionist stance.[5]

Unprecedented trade deficits and private sector complaints spawned unprecedented administrative and legislative action on trade in the past four years. In September, 1985, after four years in which the Reagan Administration repeatedly labeled the trade deficit a sign of economic strength, the Administration changed course and began vigorous if not always effective action against allegedly unfair practices by foreign States and firms. It initiated over a dozen unfairness complaints under Section 301 of the Trade Act of 1974 against countries accused of maintaining barriers to U.S. exports.[6] The Administration negotiated a cartel-like semiconductor agreement with Japan and then applied sanctions against Japan for allegedly violating the agreement.[7] According to then Treasury Secretary James Baker III, the Reagan Administration has provided more import relief than any of its predecessors in the past fifty years.[8] Meanwhile, the U.S. Congress passed (over initial objections from the Reagan Administration) a 1000-page trade reform bill,[9] unprecedented in scope and scale.

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[5] *Id.* at 83-84.

[6] Under the Trade Act of 1974, 19 U.S.C. § 2411 (1982), the President may respond to unfair trade practices by imposing import duties and restrictions. Under the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, the U.S. Trade Representative has the power to enforce this provision under presidential approval.

[7] Semiconductor Agreement, Sept. 2, 1986, United States-Japan, — U.S.T. — T.I.A.S. No. —— (numbers not yet assigned), *reprinted in* 25 I.L.M. 1409 (1986). *See* Hirsh, *International Trade Agreement Between the Government of Japan and the Government of the United States of America Concerning Trade in Semiconductor Patents*, 28 Harv. Int'l L.J. 175 (1987).

[8] Address by James Baker III, Institute for International Economics (Sept. 14, 1987). C. Aho & M. Levinson, *supra* note 4, at 84.

[9] Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107.

Sentiment is growing for the United States to abandon its traditional multilateral approach to trade and to pursue a more active trade policy, simultaneously pursuing bilateral and regional agreements with like-minded countries.[10] Others, like Congressman Gephardt, urge the United States to adopt unilaterally a tit-for-tat trade policy, retaliating against alleged unfair trade practices or against countries with persistent surpluses.[11] How Congress and the new Administration will implement the 1988 trade bill remains to be seen.

II. The Case for Multilateral Trade Policy

In the years following World War II, the GATT arose as the primary agreement regulating international trade.[12] The cornerstone supporting both political and economic arguments for the GATT is the most-favored-nation principle ("MFN").[13] Unconditional MFN requires that one nation agree to "extend to another [nation] the most favorable trade concessions it [the former] has granted, or may grant, to any third country" in some other future or existing agreement, regardless of whether the latter nation is giving the former nation any future concessions in return.[14] This principle was crucial to the GATT at its inception and remains compelling as a guiding concept today.

The arguments for unconditional MFN in the GATT fall into two categories, economic and political, with some overlap between the two.[15] The economic arguments center on efficiency.[16] States applying unconditional MFN do not discriminate among supply sources. This minimizes distortions in the market because imports come from the lowest-cost source. Unconditional MFN also promotes overall trade liberalization, since each party to the GATT opens its markets equally to all other member-States.[17] Finally, unconditional MFN is simple to administer; transaction costs at the border are significantly reduced.[18]

The political arguments for unconditional MFN emphasize its tendency to reduce tension among nations.[19] From an international political viewpoint, MFN fosters sovereign equality among nations and guarantees newcomers access to international markets.[20] The automatic extension of trade-liberalizing measures to others reduces friction and disputes.[21] In contrast, discriminatory arrangements can increase misunderstandings and disputes among different trade groupings or cause resentment on the part of outsiders.[22] Discriminatory treatment also increases the probability that trade will be used as a weapon of foreign policy.[23]

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[10] *See* Baucus, *supra* note 2, at 7.

[11] N.Y. Times, March 22, 1988, at A1, col. 4; N.Y. Times, March 15, 1988, at D2, col. 3.

[12] The GATT was originally created as the international trade rules for the proposed International Trade Organization ("ITO"). The ITO, intended to complement the International Monetary Fund and the International Bank for Reconstruction, was never ratified. The GATT survived, however, and became the central international agreement pertaining to trade. J. Jackson, World Trade and the Law of GATT 2-3 (1969).

[13] *See generally* R. Snyder, The Most-Favored-Nation Clause (1948); J. Jackson, *supra* note 12, at 249-59.

[14] Hufbauer, Shelton-Erb & Starr, *The GATT Codes and the Unconditional Most-Favored-Nation Principle*, 12 Law & Pol'y Int'l Bus. 59 (1980).

[15] Keohane, *Reciprocity in International Relations*, 40 Int'l Organization 1 (1986).

[16] Hufbauer, *Should Unconditional MFN Be Revived, Retired or Recast?*, in GATT at the Crossroads—Issues in World Trade Policy 36-38 (R. Snape ed. 1986).

[17] C. Aho & J. Aronson, Trade Talks—America Better Listen! 120 (1985).

[18] Keohane, *supra* note 15, at 12.

From a domestic political viewpoint, discriminatory restrictions are difficult to remove because they create vested interests in exporting as well as importing countries. For example, both protected domestic textile producers and supplying firms in other countries that hold quota licenses find discriminatory restrictions to their benefit.

Finally, MFN decreases the legal and legislative burdens of treating different countries unequally. Discrimination often results in domestic laws being applied differently to imports from various origins.[24] Separate national agreements increase the work of elected officials in nations, like the United States, where agreements have to be ratified by legislators. Legislative action on separate agreements also opens up the possibility of domestic political bargaining and log rolling which could undermine the original intentions of a given agreement.[25]

Although unconditional MFN is theoretically the centerpiece of the GATT system, that system also includes agreements involving conditional MFN treatment. Conditional MFN requires a reciprocal agreement between two nations granting favorable trade treatment. For example, State A extends to State B the same trade concessions it granted State C only if State B reciprocates with concessions equivalent to those given by C to A.[26] Conditional MFN can be used to expand trade, but because only a limited number of countries may join restrictive agreements, conditional MFN is inferior to unconditional MFN as a trade policy.

Some of the Tokyo Round non-tariff-barrier codes contain conditional features.[27] For example, only firms from countries that are signatories of the government procurement code may bid on the government projects that are open to foreign bids.[28] Under U.S. law, only GATT members that are signatories of the subsidies code are entitled to the injury test on subsidized exports to the United States.[29] These departures from unconditional MFN were designed to enhance discipline and thereby promote trade. They provided a mechanism for pressuring free riders and foot draggers that sought to lower standards.[30]

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[19] *Id.* at 27. Hufbauer, *supra* note 16, at 36.

[20] Keohane, *supra* note 15, at 23.

[21] *Id.*

[22] *See generally* G. Patterson, Discrimination in International Trade—The Policy Issues 1945-66 (1966).

[23] C. Aho & J. Aronson, *supra* note 17, at 120. *See also* G. Patterson, *supra* note 22, at 271-317.

[24] *See* Office of the United States Trade Representative, National Trade Estimate: 1986 Report on Foreign Trade Barriers (1986).

[25] C. Aho & J. Aronson, *supra* note 17, at 120.

[26] Keohane, *supra* note 15, at 4. For a discussion of exceptions to unconditional MFN under the GATT, see J. Jackson, *supra* note 12, at 264-72.

[27] Hufbauer, Shelton-Erb & Starr, *supra* note 14, at 61.

Other departures from unconditional MFN do not necessarily promote trade or enhance discipline. Regional groupings such as free trade areas and customs unions divert trade as well as create it. GATT members often abuse Article XXIV, which permits regional groupings.[31] Article XXIV lays out specific requirements which members seldom meet in practice, although the recent U.S.-Canadian agreement may be an exception.[32] A further proliferation of regional groupings would set precedents for more special deals, fragment the trading system, and damage the interest of non-participants.

Some scholars have suggested that the increasing number and types of exceptions to unconditional MFN have weakened, perhaps irreparably, the role of the GATT and the very model of liberal world trade.[33] However, these fears need not lead to scrapping the GATT or multilateral trade policy. While the GATT undoubtedly needs reform,[34] the overall multilateral structure survives despite its current limitations. The GATT also provides a conceptual starting point for any trade negotiations incorporating multilateralism and MFN. A policy of pursuing bilateral agreements may shift that presumption with potentially disastrous effects on the world economy and political cooperation.

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[28] Keohane, *supra* note 15, at 19. *See* G. Hufbauer & J. Shelton-Erb, Subsidies in International Trade 120-23 (1984). *See also* Jones, *The GATT-MFN System and the European Community as International Frameworks for the Regulation of Economic Activity: The Removal of Barriers to Trade in Government Procurement*, 8 Md. J. Int'l L. & Trade 53, 63 (1984).

[29] Trade Agreements Act of 1979, 19 U.S.C. § 2503 (1982).

[30] Keohane, *supra* note 15, at 12-13.

[31] GATT, *supra* note 1, at art. XXIV. For a discussion of article XXIV and the difficulties it creates for the GATT multilateral framework, see J. Jackson, *supra* note 12, at 575-623. *See also* K. Dam, The GATT: Law and International Economic Organization 274-96 (1970); Baucus, *supra* note 2, at 19-21.

[32] For an historical analysis of the relationship between limited agreements and multilateral agreements see Diebold, *The History and the Issues*, in Bilateralism, Multilateralism and Canada in U.S. Trade Policy (W. Diebold ed. 1988).

[33] Hufbauer, Shelton-Erb & Starr, *supra* note 14, at 91-93. Jackson has termed the weakening of unconditional MFN a "crisis of confidence in the international trade system." Jackson, *The Crumbling Institutions of the Liberal Trade System*, 12 J. World Trade L. 93 (1978).

[34] *See infra* notes 66-72 and accompanying text.

III. Generic Problems with Bilateral Free Trade Agreements[35]

Bilateral free trade agreements are justified only in special cases. For example, the U.S.-Israeli free trade agreement has outstanding political implications.[36] The U.S.-Canadian free trade agreement and the European Community may be special cases in light of the proximity and interdependence of the member-States.[37] In his 1988 State of the Union address, President Reagan spoke of including Mexico in a North American trade accord.[38] Beyond these examples, further bilaterals would seriously undermine the world trading system.

A. Historical Antecedents

Advocates of more bilaterals in the Administration and on Capitol Hill would do well to remember the lessons of the 1930s. When the GATT was signed, the world had barely receded from the dire consequences of trade discrimination. In the wake of the Smoot-Hawley Tariff[39] and subsequent retaliation,[40] many countries tried to protect their own economies by establishing bilateral or regional agreements.[41] Such "beggar-thy-neighbor" strategies spread, deepening the world's economic decline.[42] The lessons of the 1930s teach that bilateral agreements fail as mechanisms of international economic regulation,[43] impoverishing the international community for the short term benefit of a few States.[44]

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[35] The treatment of bilateral agreements in this section focuses solely on bilateral free trade agreements and not on bilateral negotiations generally. For a more general discussion, see Diebold, *supra* note 32.

[36] C. Aho & M. Levinson, *supra* note 4, at 94.

[37] *See* M. Schnitzer, M. Liebrenz & K. Kubin, International Business 389 (1985).

[38] *See* Diebold, *supra* note 32, at 160. *See also* Baucus, *supra* note 2, at 17-18.

[39] Signed in 1930, the Smoot-Hawley Tariff contributed significantly to the Great Depression. *See* Cooper, *Trade Policy and Foreign Policy*, in University of Michigan Conference on U.S. Trade Policies in a Changing World Economy 2 (Mar. 28-29 1985).

[40] In the months following the passage of the Smoot-Hawley Tariff, twenty-five countries retaliated with higher tariffs. C. Aho & J. Aronson, *supra* note 17, at 16.

[41] John Maynard Keynes described the situation for the United States as a period requiring a policy "to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbor which is worsted in the struggle." J. M. Keynes, The General Theory of Employment Interest and Money 382-83 (1936), *quoted in* G. Curzon, Multilateral Commercial Diplomacy 28 (1965).

[42] C. Aho & J. Aronson, *supra* note 17, at 16. *See also* Robinson, *Beggar-Thy-Neighbor Remedies for Unemployment*, in Readings in the Theory of International Trade 393-407 (1949) (offering a justification for such trade behavior).

[43] *See* H.W. Arndt, The Economic Lessons of the Nineteen-Thirties 17 (1944).

[44] C. Aho & J. Aronson, *supra* note 17, at 16. *See* League of Nations, Commercial Policy in the Interwar Period: International Proposals and National Policies 70-71 (1942).

B. Economic Considerations

The arguments against bilateralism are both economic and political. In short, a succession of bilateral trade agreements will create resentment and inefficiency, increase bureaucracy, and send unwise signals to other nations.[45]

From an economic perspective, bilateralism places obstacles in the path of free movement of goods and capital.[46] The desire to strike political balance between nations takes precedence over consideration of comparative resource endowments. Therefore, a bilateral system of trade prevents the efficient use of the world's resources.[47]

Trade policy founded on a series of bilateral agreements creates an environment of unpredictability and discourages trade-related business investment. The perception that bilaterals expand markets for businesses in the participating States is often illusory or at best short term; the conclusion of a second or third discriminatory bilateral agreement necessarily disappoints expectations and opportunities created by the first.[48] If other nations follow the U.S. lead and negotiate bilateral agreements offering mutually incompatible privileges, predictability and stability would be destroyed for all States.

The experience of the 1930s shows how difficult it becomes for businesses to bear the risks of trade-related investment when changes in trade protection become less predictable. Heavy losses in output and employment occur when investment is reduced and directed into less rewarding projects. Moreover, trade policy conflicts resulting in a decline in trade and world output can provide fertile ground for political radicals to seize the reins of government.[49]

C. Political Considerations

Inextricably linked to the economic concerns are political factors which argue against a bilateral approach to international trade. Friction may develop between parties to a bilateral agreement,[50] especially when a party to a bilateral decides to open up trade with a third State.

The essence of bilaterals is that a State plays favorites. Tensions with third parties are bound to develop because of the discriminatory treatment,[51] producing resentment and distrust in the excluded

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[45] C. Aho & M. Levinson, *supra* note 4, at 94.

[46] *See* R. Gardner, Sterling-Dollar Diplomacy 13 (1956).

[47] *Id.*

[48] *Id.*; Ellis, *Bilateralism and the Future of International Trade*, in Readings in the Theory of International Trade, *supra* note 42, at 415-47.

[49] For a detailed analysis together with a dramatic chart of the downward spiral of trade, see C. Kindleberger, The World in Depression 171-72 (1973).

[50] *See* Diebold, *supra* note 15, at 87.

[51] In 1919, the Tariff Commission concluded that

> a policy of special arrangements . . . leads to troublesome complications. Whether as regards our reciprocity treaties or as regards our interpretation of the most-favored-nation clause, the separate and individual treatment of

nations.[52] The effect on developing nations could be particularly acute. For left-of-center politicians in many third world States, discriminatory bilateral arrangements may well smack of colonialism.[53] The development of a globally consistent, stable system of trade requires effective equality of rights and obligations among States, which can be ensured only by general acceptance of the principle of nondiscrimination, otherwise known as most-favored-nation treatment. This principle mobilizes large nations to support the aspirations of small nations to be treated equally. In no other way can the sovereign equality of nations which differ enormously in size and power be realized, or even approximated.

The United States, Japan and the European Community—the major pillars of the trading system—cannot afford to be in rival blocs. Although the United States has expressed some frustration with the European Community for slowing the multilateral process and with Japan over market access, Western cooperation remains important for strategic and security reasons and must not be undermined. The best message of alliance cohesion the Western nations can send to Eastern bloc nations is a flourishing, unified and nondiscriminatory trading system. A fragmented trading system with friction and discrimination would send precisely the wrong signal.

Aside from international politics, domestic political considerations also argue against a policy of bilateralism. A strategy of bilateralism would necessarily require that Congress play a major role in formulating trade policy. Consider how members of Congress will be whipsawed by short term national interest as well as sectoral interests. Legislative action on separate agreements opens up the possibility that trade will be used as a weapon of foreign policy against countries failing to follow U.S. foreign policy initiatives. Some legislators, pressured by special interest groups, may seek to discriminate in the application of domestic law. In sum, a bilateral strategy would raise trade policy from "low level" to "high level" foreign policy. The new Secretary of State, James A. Baker III, would end up spending more time on the balance of trade, leaving him less time to spend on the balance of terror. That would be a gross misallocation of resources.

Regardless of the perspective, bilaterals or like-minded groupings are an inferior alternative when compared with multilateral liberalization on a nondiscriminatory basis.[54] Politically, bilaterals discriminate and create foreign policy problems. Economically, bilaterals fragment the international trading system. The United States needs to generate trade surpluses of up to $50 billion to service its trillion dollar foreign

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> each case tends to create misunderstanding and friction with countries which, though supposed to be not concerned, yet are in reality much concerned.

Quoted in W. Diebold, *supra* note 32, at 3.

[52] C. Aho & M. Levinson, *supra* note 4, at 94.

[53] For an extended discussion of the drawbacks, see C. Aho & J. Aronson, *supra* note 17, at ch. 7.

[54] *See* C. Aho & J. Aronson, *supra* note 17, at 17.

debt in the 1990s.[55] Without an open multilateral trading system, that will be next to impossible.

IV. Drawbacks of a Bilateral with Japan

Despite the arguments against negotiating a series of bilateral agreements, policy-makers persist in proposing an accord with Japan.[56] They base these proposals either on false premises or a misreading of the potential gains by paying insufficient attention to the negative consequences.

A. Tactical Considerations

Proponents of a bilateral trade agreement with Japan cite the corrosive effect that bilateral disputes have had on the U.S.-Japanese relationship and the ineffectiveness of the piecemeal approach to solving these disputes.[57] There are, however, several barriers to a U.S.-Japan accord. Before such an agreement can be effectuated, the trade policy process in the United States must be internally reformed to establish and highlight trade priorities. Otherwise, the U.S. will not overcome the disputes with Japan through a bilateral agreement. Moreover, the U.S. should not assume—even if it did change its policy—that Japan would be any more able or willing to accede to U.S. demands on contentious issues, such as agriculture and construction policy.[58] Multilateral rather than bilateral pressure would be more effective and more palatable politically within Japan.

A bilateral trade agreement with Japan would be a mistaken strategic move in U.S. trade policy. Foremost, it would tie the hands of American trade negotiators. The launch of the Uruguay Round at Punte del Este demonstrated the importance of coalition building in future trade negotiations. Since coalitions shift from issue to issue, it is better to retain the flexibility to form different coalitions than to limit options by joining a bilateral with another major pillar of the trading system. For example, the United States might someday wish to join forces with the European Community in a multilateral forum on the issue of market access to Japan, but may later have to join with Japan to ensure that the European Community does not use the 1992 effort as a means to discriminate against outside interests.

Furthermore, if the United States does enter into a bilateral trade agreement, it is not at all obvious that Japan is the most appropriate partner. Senator Baucus prefers a bilateral with Japan,[59] while Congressman Gephardt has proposed that the European Community should be the object of U.S. bilateral initiatives.[60] Senator Bradley favors a plurilateral trade agreement with the Pacific Rim nations.[61] Who is going to decide and on what basis?

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[55] For references and an extended discussion of the problems of servicing U.S. foreign debt, see C. Aho & M. Levinson, *supra* note 4, at ch. 2.

[56] *See, e.g.*, Baucus, *supra* note 2, at 8-17; *Groping for a Practical New Order in World Trade*, N.Y. Times, Aug. 30, 1987, at 30.

[57] *See* Baucus, *supra* note 2, at 12.

[58] *See* C. Aho & M. Levinson, *supra* note 4, at 85.

[59] *See* Baucus, *supra* note 2, at 8-17.

Granted, new approaches to trade policy in a highly pluralistic world may bring needed pressure on free riders and foot draggers. The preferred approach, however, is to remain within the GATT and develop the conditional MFN approach as was done with the Tokyo Round, where only signatories to the new codes received the benefits of abiding by the additional discipline.[62] Since the free riders and foot draggers will vary from issue to issue, conditional MFN allows for greater flexibility.

B. Practical Considerations

Beyond these tactical issues, there are several practical reasons to reject a bilateral trade accord with Japan. The drawbacks are manifold. First, negotiation of a traditional free trade agreement is too modest a goal. Even if the agreement covered tariffs and non-tariff barriers or included such new issues as trade in services, intellectual property and foreign investment, the two nations would have failed to address significant problems. The most difficult problems the United States has with Japan, including the distribution system and cultural preferences, are not susceptible to negotiation by formula or by drafting new trade rules.

Second, the concessionary nature of negotiations requires that the United States "give up" something in order to receive something out of an agreement. This may mean dismantling import restraints on steel, autos, semiconductors, machine tools, textiles and the other barriers that remain to Japanese exports to the United States. The U.S. Congress might have to construct an institutional apparatus for dispute settlement that would allow frictions with Japan to skirt U.S. trade remedy laws. Particular interest groups and members of Congress are likely to think that this would give up too much control.

Third, while the new U.S.-Canadian bilateral is a good agreement, it still failed to address many of the central difficulties of trade between the two countries. The accord does not address subsidies, trade remedy actions, government procurement, or intellectual property.[63] This agreement took almost two years to negotiate, and the talks came perilously close to collapse on several occasions. Moreover, even after Canada and the United States reached an agreement and the U.S. Congress ratified the accord, the Canadian public nearly rejected the agreement by coming close to voting out the conservative Mulrooney government responsible for its negotiation. Indeed, the agreement became the central issue of Canada's national campaign.[64] Before launching another bilateral, it would be wise to wait and see how the agreement with Canada works out.

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[60] Address by Representative Richard Gephardt, "United States Trade Policy for the 1990s," George Washington University Law Society (Oct. 12, 1988).

[61] Address by Senator Bill Bradley, New York Economic Club (Dec. 8, 1988).

[62] *See* Hufbauer, Shelton-Erb & Starr, *supra* note 14, 61.

[63] For an assessment of unfinished business and for an analysis of how the bilateral agreement might blend with the multilateral talks, see Diebold, *supra* note 32.

Fourth, since both the U.S. and Japan have substantial trade interests and business investments in other countries, establishment of a new bilateral would divert trade and investment. This would result in economic inefficiency, raising consumer costs and altering sourcing patterns for firms with subsidiary operations in other countries. The extent of the net inefficiencies created would depend upon the balance between trade creation and trade diversion.[65] Nonetheless, some consumers, affected multinational corporations, and third-country business interests would have cause to complain.

Fifth, even the onset of negotiations between the U.S. and Japan would cause other countries to change their behavior—and not necessarily in ways conducive to reaching a multilateral agreement. Other Asian countries, for example, would likely clamor for similar negotiations with either Japan or the United States (Asia's major trading partners), or both. The United States lacks the capability to conduct a series of bilaterals simultaneously, but could not afford to defer resolution of these requests until the U.S.-Japanese negotiations were completed.

Finally, the U.S. must carefully compare the costs of failure with the likely gains from any agreement. As any negotiations of this type proceed, the negotiators must realize that if they fail it is often impossible to return to the *status quo ante.* Under such circumstances, negotiators are hard pressed to come up with an agreement, no matter how bad or how unworkable. The gains of a bilateral accord with Japan are unlikely to be so great as to warrant risking the trading system as it now stands.

V. A Strategy for the New President

A. Reform the GATT

A great deal needs to be done to reform the international trading system. The GATT is one of the three major international institutions originally designed to help stabilize the world economy in the post-World War II environment. The GATT, however, does not have the authority in trade that the International Monetary Fund has in finance or the World Bank has in development.[66] The GATT is an administrative agency with a professional staff of fewer than 200 people (compared with 1700 for the IMF and over 6000 at the World Bank).[67] The deficiencies of the GATT, or more accurately of the GATT system, have become apparent in recent years.[68]

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[64] N.Y. Times, Oct. 2, 1988, at A5, col. 1.

[65] For the classic statement of the concepts of trade diversion and trade creation, see J. Viner, The Customs Union Issue (1950).

[66] C. Aho & M. Levinson, *supra* note 4, at 87.

[67] *Id.*

The GATT needs several institutional reforms. The adjudication of disputes and enforcement of rules needs strengthening,[69] and rules on subsidies and unfair trade need revamping.[70] The GATT must become more of a forum for the mediation and reconciliation of trade disputes not explicitly covered by existing rules.[71] The GATT should aim at responding to problems as they emerge. These reforms share the common goal of heightening the respect and authority of the GATT in the international community. International policy makers can make and implement the changes detailed above through multilateral negotiations already in progress. The Uruguay Round is currently addressing many of these issues.

Beyond institutional reforms, the GATT mirrors the cooperation that its members invest. Unfortunately, international cooperation on trade may be at its lowest level since World War II. Political will is a necessity in all countries—but especially in the United States. Ensuring success of the Uruguay Round, therefore, should be the first trade priority of the next President. Although working for change will be arduous, the stakes are too high not to continue trying.[72]

B. Opening Markets and Deterring Barriers Through Retaliation

U.S. trade policy should emphasize the opening of foreign markets over the protection of domestic industries. The United States should pursue an aggressive policy of deterrence and retaliation toward the end of strengthening adherence to internationally established rules of trade.[73]

Discussions of international trade invariably underestimate the importance of deterrence, although it is elemental in understanding strategic relations among nations. Some advocates of free trade mistakenly believe that tolerating offensive behavior without retaliation is an admirable form of self-restraint. Though tolerance may signal U.S. commitment to a liberal trading order, it also allows other countries to infringe upon trading rules without prosecution. Yet, reluctance to retaliate is enshrined in American trade law. Where the U.S. does impose sanctions, the intent is protectionist rather than market-opening. Retaliation, however, far from being something to avoid at all costs, is a necessary part of a self-regulating world system of free trade. Unfortunately, under current GATT procedures, the probability that a country illegally interfering with trade will suffer major economic harm from retaliatory actions is extremely low. The deterrent effect is negligible.

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[68] For an excellent treatment of the deficiencies of the GATT system, see M. Camps & W. Diebold, The New Multilateralism 37-72 (1986).

[69] *Id.* at 43-44.

[70] *Id.* at 40.

[71] *Id.* at 49-55.

[72] For an analysis of the difficulties, see C. Aho & J. Aronson, *supra* note 17.

[73] *See generally* I. Destler, American Trade Politics: System Under Stress (1986).

The next President should retaliate against foreign barriers that clearly violate internationally defined rules of the world trading system. In each instance of retaliation, the United States should define clearly and state publicly what actions on the offending nation's part will cause the U.S. to lift the retaliatory measures. In addition, retaliation should occur only within the realm of international trade, to make it clear that the United States has no desire to allow trade disputes to poison other aspects of international relations. Ideally, trading partners would be confident that eliminating the objectionable practice would end U.S. interference with their exports.

Unfortunately, current U.S. laws cloud the potential clarity of a trade policy employing retaliation. Individual companies and industries may file for import relief with little cost and no risk, giving them an inordinate influence in setting U.S. trade policy and stripping American diplomats of much of their bargaining leverage. A trading partner has little incentive to compromise to avert retaliation when it knows that any individual American company can still obtain sanctions against it. The deterrent effect of calibrated, government-initiated retaliation is lost. Some of the current U.S. laws allowing private actions should be traded away at the Uruguay Round and replaced by a specific policy of retaliation, granting the President the flexibility to impose and withdraw retaliatory penalties.

The 1988 trade bill has already taken some steps in reforming U.S. law and policy, emphasizing market-opening retaliation over market-closing protection. The publication of foreign trade barriers to U.S. exports, as required by law, and the occasional public disclosure of lists of retaliation targets may also deter the further spread of barriers. If new barriers are erected, the United States could publicly identify some of the items on the list of retaliatory targets in order to mobilize the public sector in the offending country.[74]

Applying deterrence to trade policy does carry with it the risks of escalation, retaliation, and counter-retaliation. Careful selection of targets for retaliation can reduce some of these risks. Such targetting requires a competence and an objectivity on the part of officials in the executive branch, both in choosing barriers to retaliate against and in selecting the targets of retaliation. Although it offers one possible means of maintaining a self-enforcing system of international trading rules, this approach requires the adoption of well defined rules. The ongoing multilateral talks under the auspices of the GATT provide the best opportunity to improve the rules that govern trade.

Opening new markets, as the supporters of bilateral agreements suggest, is a crucial step, but it is a step best taken within the multilateral trade framework. President Bush should initiate reforms of the GATT through the Uruguay Round and promote a strong policy of retaliation against GATT violators. These efforts risk failure, however, unless he also can successfully manage domestic trade politics.

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[74] M. Levinson, Trade Policy or Trade Strategy (Working Paper for a Council on Foreign Relations study group on the Economic Choices Confronting the Next President, New York (May 10, 1988) (unpublished manuscript).

C. Managing the Domestic Trade Front

A major lesson of the past decade is that it is not enough for the President to negotiate freer trade with other countries. He must also attend to the domestic front on trade matters. He must do more to involve the private sector and Congress in making trade policy. He must mobilize private sector support and keep Congress constantly apprised of the negotiations. He must convince Congress and the public that he is according trade matters their due priority and is protecting American interests.

A frank policy of retaliation against foreign barriers would provide visible evidence to the domestic political arena that the U.S. government is vigorously asserting the country's interest in trade matters. This will help establish presidential credibility on trade, greatly diminishing protectionist pressures on the domestic front.

The new administration must continue to push hard for visible signs of progress. Unless a new multilateral accord resolves basic issues of disagreement, trade frictions with Japan and the European Community are likely to escalate in the decade ahead. Yet the United States should not succumb to pressures to resolve trade frustrations through numerous bilateral accords. The break-up of the world trading system into regional blocs, each based upon separate bilateral agreements, is directly contrary to the long-established U.S. goal of liberalizing the international flow of goods and services.

Perhaps most importantly, the new President must lead the formulation of American trade policy. The political structure for handling trade issues requires that the President take the lead in order to protect members of Congress from intense pressure to save local factories and mines from import competition. When the chief executive fails to assume the role of advocate and lightning rod on trade matters, as was the case throughout the Reagan years, the protectionist pressures may be impossible for Congress to withstand.

Conclusion

As the new U.S. administration struggles to find its way on trade policy, the world will await nervously. George Bush will face enormous pressure to abandon the United States' traditional commitment to the multilateral process and instead to cut bilateral deals. The President must stand firm, supporting the multilateral process and retaliating against those States that break internationally accepted rules. Trade can no longer be treated as a stepchild of domestic economic policy at home and of foreign policy abroad. It must be a continuing priority.

PREPARED STATEMENT OF SENATOR MAX BAUCUS

America faces severe international trade challenges.

The trade deficit remains at the unsustainable level of about $140 billion a year. And, instead of getting better, it threatens to deteriorate in 1989.

The U.S. has had great difficulty gaining access to Japan, Korea, and other nations for U.S. exports.

The Uruguay Round of GATT negotiations seems to be floundering over the difficult issues of agricultural subsidies and protection of intellectual property.

The prospect of a single European Market by 1992 raises the potential of further trade challenges in the near future.

The only real bright spot in the current trade picture is the U.S.-Canada free trade agreement.

The FTA reduced tariffs and liberalized trade between the U.S. and Canada. After some debate on both sides of the border, the agreement was ratified and took effect on January 1, 1989.

There is a lesson here for the Bush Administration.

The challenges we face are forcing broad and fundamental changes on the international trading environment.

The Bush Administration—in consultation with Congress—must revise American trade policy in light of those changes.

We certainly should not throw the baby out with bath water.

Some parts of U.S. trade policy work and work well. And with passage of the 1988 Omnibus Trade Act, Congress has provided the Administration with new tools that may prove useful.

But there is room for improvement. It is time for the U.S. government to re-think its international trade strategy.

The system needs a shot in the arm.

I believe that a new bilateral or plurilateral trading arrangement with the nations of the Pacific Rim—particularly Japan—may be just the shot in the arm we need.

There are three new trade developments that we must consider as we forge our trade policy: the troubled Uruguay Round, the prospect of a single European market by 1992, and the implementation of the 1988 Omnibus Trade Act.

Each of these developments strengthens the case for looking to the Pacific Rim.

The Uruguay Round of GATT talks is floundering badly after the breakdown of the mid-term negotiations in Montreal.

I am optimistic that we can salvage the round during the April meeting of the GATT Ministers in Geneva. But we should revise our expectations.

Even if the GATT Round does begin moving in April, a final agreement is still some years away.

Further, the EC is dead set against eliminating agricultural subsidies and Brazil and India will block efforts to protect intellectual property. This puts a limit on the progress that we can hope for in these areas.

We are unlikely to conclude a GATT agreement that meets all of our objectives in the foreseeable future.

We need a second option.

Talks with the nations of the Pacific Rim serve as a warning to our trading partners against dragging their feet in the GATT Round. It also provides us with an insurance policy in case the GATT breaks down.

Further, bilateral or plurilateral talks provide a way to strengthen international trading rules in areas where the GATT is weak. Finally, as the services title of the U.S.-Canada FTA demonstrated, bilateral and plurilateral talks can even point the way for future GATT agreements.

Bilateral and plurilateral talks are the perfect complement to the Uruguay Round—especially if the U.S. strives to conclude open, non-discriminatory trading arrangements with its Pacific Rim trading partners.

We must also keep an eye on EC 1992.

We shouldn't overreact. But there is a real risk of Europe retreating into Fortress Europe as EC 92 proceeds.

We must let Brussels know in no uncertain terms that the U.S. will not take the prospect of Fortress Europe lying down.

Perhaps the most effective way to do this is to initiate negotiations with the nations of the Pacific Rim.

The goal of these negotiations should not be developing a bloc that excludes Europe. But, if the nations *of the Pacific Rim find themselves shut out* of Europe, they will have a viable counterthreat.

The threat of "Fortress Pacific" is the most effective counterbalance to Fortress Europe.

Finally, we should take full advantage of the new tools provided by the Omnibus Trade Act.

The Super 301 provision of the trade act makes a new round of trade negotiations with the nations of the Pacific Rim a certainty. The only question is the scope and setting for these negotiations.

I strongly advise the Bush Administration to use Super 301 as an opportunity to make progress, not as another requirement to meet.

Super 301 should be the springboard for launching a major trade and economic negotiation with Japan, Korea, and the other nations of the Pacific Rim.

In the words of Mike Smith, former Deputy USTR: "The time is right to look to the Pacific Rim."

The times call for the Bush Administration to develop an aggressive, pragmatic trade policy. We cannot afford to close our minds to new alternatives.

I am pleased that we have been able to assemble an excellent panel of witnesses to discuss this issue today.

Most points of view are ably represented here.

I think we will all find this discussion very helpful as we strive to develop a U.S. trade policy.

PREPARED STATEMENT OF C. FRED BERGSTEN AND JEFFREY J. SCHOTT

MORE BILATERAL TRADE AGREEMENTS?

In recent years, the United States has negotiated free trade agreements (FTA's) with Israel and Canada to promote trade liberalization and to try to resolve longstanding bilateral trade disputes. These bilateral negotiations have been part of a two-track US strategy to provide a complement to, and potentially a substitute for, multilateral efforts to liberalize trade.

The success of the FTA's with Israel and Canada has raised questions whether the United States should concentrate on additional bilateral FTA's rather than on the multilateral trade negotiations now underway under the auspices of the General Agreement on Tariffs and Trade (GATT) There has been discussion of new bilateral trade agreements, particularly with Japan and others in the Pacific Basin. Such proposals appear to have two motives: to provide building blocks for broader multilateral agreements and fallbacks against a possible breakdown in the GATT talks, and to reduce US trade deficits with the key surplus countries (including Japan, Taiwan and Korea).

Should the United States continue to pursue FTA's with other countries or should it devote its efforts to the negotiation of new multilateral agreements in GATT in the Uruguay Round? Can it do both?

The Institute for International Economics recently held a conference on "More Free Trade Areas?" to address these questions. The conference discussed the feasibility and desirability of negotiating free trade areas between the United States and countries in the Pacific Basin, as well as Mexico and possibly the European Community (as proposed by Congressman Gephardt) It evaluated the problems that would need to be addressed in prospective talks, including concessions that both parties might have to make. It examined the implications for nonmember countries, and the compatibility of such prospective FTA's with the GATT, to determine the costs and benefits to the United States and to the international trading system as a whole of proceeding down this road.

The Institute will shortly publish the policy conclusions and recommendations that emerged from the conference.[1] Today we would like to present our preliminary findings on the efficacy of negotiating more FTA's. We will also comment on the multifaceted proposal by Senator Baucus for a new United States-Japan bilateral agreement—both going beyond, and falling short of, a FTA as usually defined.

U.S. OBJECTIVES

The first issue is what the United States could achieve through FTA's, and whether FTA's would complement or substitute for multilateral negotiations aimed at those same objectives. Three traditional goals and one new goal, at least for trade policy, have been put forward by proponents of the FTA approach:

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[1] Jeffrey J. Schott, *More Free Trade Areas?* Policy Analyses in International Economics 27. Washington: Institute for International Economics, April 1989. The conference papers will appear in a volume edited by Jeffrey Schott, *Free Trade Areas and US Trade Policy,* that will be released by the Institute in May 1989.

1. *Reduce foreign barriers to US exports.* Proponents argue that FTA's are more likely than multilateral efforts to result in trade liberalization, for three reasons. The negotiating process, being limited to two or a few countries, would be less complex and time-consuming. The FTA's would likely involve countries that share similar or complementary objectives. Countries may be more willing to lower trade barriers if the reforms are accorded only to the partner countries, eliminating the free-rider problem that often arises due to the most- favored-nation obligation in the GATT.

However, trade problems are not necessarily easier to resolve because there are fewer negotiators. Indeed, it often takes more players to increase the aggregate stakes in a negotiation to a level that will justify concessions in domestic political terms. In other words, it may take a multilateral negotiation to generate a "pot" big enough to induce countries to put forward economically desirable but politically difficult concessions to achieve reciprocal benefits. The failure of US and Canadian negotiators to achieve major reforms in subsidy practices is a case in point.

Indeed, we found that FTA's hold little promise of substantial trade reform. The main trade concessions would likely be in the area of tariffs, while the more restrictive nontariff barriers (NTBs) would likely remain intact. The US ability to negotiate reductions in such barriers would be constrained unless we were willing to put US NTBs on the table in sensitive areas such as textiles, clothing, and steel. Moreover, as noted above, many of these barriers are not amenable to bilateral solutions.

This point is particularly important at the present time, when the United States needs an improvement of about $150 billion in its trade balance to stop the future buildup of our foreign debt and our reliance on foreign financing. It is difficult to conceive of any series of bilateral agreements that would open markets to our exports sufficiently to promote that goal. A successful Uruguay Round is in fact crucial to eliminating the US trade deficit.[2]

Furthermore, it is not clear that GATT talks are more complicated than a series of bilateral FTA's. Consultations among a few key delegations set the pace for most GATT negotiations. The FTA agenda would likely parallel or go beyond the GATT agenda. And it might be more complicated to negotiate several FTA's than one multilateral round; many observers at our conference warned that USTR would have to greatly expand its resources to handle a series of such efforts.

2. *Promote new multilateral accords.* FTA's can be used as both carrot and stick to pursue multilateral trade reforms in GATT. For example, provisions in the Canada-US FTA on services, investment, and dispute settlement could serve as models for broader GATT accords on those "new" issues (where GATT discipline is lacking) At the same time, the threat of bilateral negotiations can be employed to "to keep other countries' feet to the fire" in GATT. We will come back to this crucial point later.

However, Japan and other countries in the Pacific Basin seem to be interested in FTA's with the United States primarily because of concerns over a further drift toward US protectionism and bilateralism. The reasons most frequently cited during our conference for foreign interest in FTA's were (1) to avoid US retaliation (pursuant to section 301 cases); (2) to secure better access to the US market through a reduction of current barriers or, at least, a standstill on future restrictions; and (3) to avoid discrimination if other countries negotiate FTA's with the United States. These goals indicate that foreign countries do not see FTA's as a complement to GATT negotiations, but rather as a substitute for the Uruguay Round given what they perceive may be the future course of US trade policy.

The pursuit of more FTA's would send a clear signal to other countries that the United States was disillusioned with the multilateral process and that US support for the Uruguay Round was eroding. In most instances, this perception would trigger a defensive reaction, driven by a fear of growing US protectionism and of a further weakening of GATT discipline, to turn away from GATT talks in deference to securing trade preferences in the US market through the negotiation of a bilateral FTA.

3. *Improve management of bilateral trade relations.* By their nature, FTA's accord enhanced priority to bilateral trade relations between the partner countries. New consultative and dispute settlement mechanisms can be built into FTA's to supervise the operation of the agreement, and to monitor and enforce its rights and obli-

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[2] C. Fred Bergsten, *America in the World Economy: A Strategy for the 1990s.* Washington: Institute for International Economics, November 1988. See especially chapter 6.

gations. Such mechanisms could in fact provide a means to preempt potential disputes. The binational trade commission, and the provision for binding arbitration to resolve certain types of disputes, that were incorporated in the Canada-US FTA could be useful models for other FTA's. Such provisions seem to be of particular interest to Japan and other countries in the Pacific Basin.

The establishment of such procedures need not require a full-blown FTA. Such consultative and dispute settlement mechanisms also could be incorporated in a revised FCN treaty or in other types of trade pacts. Note, however, that the existence of various bilateral dispute settlement mechanisms could raise problems with regard to the consistency of rulings. For example, different bilateral panels could put forward conflicting interpretations of US obligations regarding the administration of its unfair trade statutes, creating a tangled web of precedents that would confound government administrators and enrich trade lawyers.

4. *Reduce bilateral trade imbalances.* Some proponents favor FTA's as a means to redress bilateral trade imbalances. This rationale has been evoked by some observers in Asian newly industrializing countries (NICs) that would hope to use FTA's to limit purchases from Japan in favor of US suppliers (and perhaps voluntarily restrain exports to the United States as well) thereby deflecting US pressures against their global trade surpluses. The objective is trade diversion—which is normally regarded as a major *cost* of FTA's.

Moreover, any efforts by foreign countries to reduce their bilateral trade surplus with United States simply through one- shot buying missions or gold purchases, which some proponents of new FTA's seem to have in mind, would yield little in terms of trade improvement or political goodwill. Both require a more sustained performance that only can be achieved through complementary changes in macroeconomic and exchange rate policies by the United States and its trading partners.

POLICY CONCLUSIONS

Based on the discussions at our conference, we have derived a series of policy conclusions:

1. Almost all close observers of trade policy, whether advocating freer trade or more overt management of trade flows, are dissatisfied with the status quo. There is widespread pressure for new initiatives, and the only issue is the nature of those initiatives.

2. Almost everyone agrees that trade policy, whether pursued through multilateral or bilateral means, can do little to correct the trade deficit. That is primarily a matter for macroeconomic and exchange-rate policy in the United States and abroad.

3. Almost everyone agrees that the multilateral approach to renewed trade liberalization is preferable, and that bilateralism could lead to a mind-boggling proliferation of overlapping and retaliatory deals. The main question is whether adequate progress through the multilateral approach is feasible.

4. Confidence in the GATT and the multilateral process has eroded substantially. In fact, disillusion with multilateralism may be the fundamental explanation for the rise of interest in "the bilateral option." It is like the old joke about the beauty contest: "having seen A, we choose B."

5. But the same problems that are impeding progress on the multilateral front—the unwillingness of countries to make meaningful and politically difficult concessions concerning their own policies—would equally impede bilateral progress. There is nothing specific to the GATT that makes its process more difficult:

a. The problem of "too many countries" is not very serious in practice, since agreements among the major countries largely determine the outcome anyway.

b. The "free rider" problem can be circumvented by the use of conditional MFN agreements on all nontariff issues, as done already in the subsidies and procurement codes in the Tokyo Round.

c. The GATT machinery may not be perfect, but it is getting better and it has the virtue of being in existence.

d. The same problem holds with regard to trade balances and macroeconomic policies: would a bilateral agreement with Japan really improve the prospects for correcting the US budget deficit?

6. Moreover, it is not at all clear that an extensive series of bilaterals—as opposed to the special cases of geographical propinquity (US-Canada, Australia-New Zealand, Argentina-Brazil)—would be complementary rather than competitive with the multilateral process. As noted above, most potential partners in FTA's with the United States are pursuing them defensively to take out insurance against new protection and further erosion of the multilateral process.

7. The "resort to bilaterals" is thus largely a copout, a search for a *deus ex machina* that will somehow circumvent the core problems. Unfortunately, no such magic solution exists. Hence the perceived benefits of the bilateral approach are basically illusory.

8. Having weighed all this, we conclude that US pursuit of the bilateral or regional option would be *counterproductive* for the next few years and would *undermine* the major US interest in rapid further liberalization of world markets (to support the essential elimination of our trade and current account deficits):

a. The United States cannot possibly achieve the liberalization it needs from even the most extensive possible series of bilateral and regional deals. Key issues such as agriculture and subsidies can only be resolved globally, as we learned in the negotiations with Canada.

b. Talk of blocs and bilateral deals has become so pervasive, both here and in other key countries, that it threatens to become a self-fulfilling prophecy. Scarce time and resources in an increasing number of countries are being devoted to developing and pursuing bilateral or regional approaches, largely in defensive reaction to perceived movement toward blocs elsewhere, at the expense of the Uruguay Round.

c. While the threat of more FTA's between the United States and its trading partners may "scare" countries back to the GATT bargaining table, it also may prompt perverse bilateral responses. Smaller countries might forsake the GATT talks and rush to join the FTA queue, while larger traders such as the EC might build their own trading blocs—indeed, proponents of a fortress Europe are bolstered by US efforts to negotiate outside of GATT.

d. US efforts to do new bilateral deals would imply that the United States was giving up on the Uruguay Round and the GATT, even if it continued to espouse support for the multilateral approach. A scramble for FTA's would then ensue, leading other countries to downplay (or forget about) the multilateral process in an effort to achieve stability in their bilateral relationship with the United States, because they would perceive that the United States was walking away from the Uruguay Round. The self-fulfilling prophecy could easily be realized.

e. If the United States were to deviate from its leadership of the Uruguay Round, no other leader would come forward and the Round would falter and probably collapse. If the US Government were to stop championing the Uruguay Round internally, support for it within the United States would dissolve.

9. *We have therefore concluded that the two-track approach, which made sense when it was unclear whether we would have a Uruguay Round and when the bilateral track was limited to Canada, would be the worst of all worlds for US trade policy over the next few years.* It could torpedo the Round without any significant offsetting benefits on the bilateral side. *We therefore recommend that the United States publicly eschew any further pursuit of bilaterals until the outcome of the Uruguay Round is clear, and but all its energies into that effort.*

10. If the Round fails, the nonmultilateral option can be examined again. Even then, however, bilaterals would be only a *third* best. The preferred fallback would be a "mini-GATT" of as many like-minded countries as would choose to participate, rather than a regionally oriented series of deals along bilateral or plurilateral lines.

11. One of our conferees concluded her remarks by paraphrasing Churchill: "the multilateral approach is the worst of all possible systems, except for the alternatives." We fully agree, and would counsel that United States policy move decisively in that direction.

THE BAUCUS PROPOSALS

The general views on FTA's noted above do not respond directly to the creative proposals set out by Senator Baucus in introducing S. 292 on January 31, 1989. His scheme goes beyond the usual FTA approach, because it would include close coordination on macroeconomic and monetary issues. It also falls short of a "normal" FTA in trade policy terms, emphasizing a new consultative mechanism rather than an elimination or even sharp reduction of existing trade barriers between the countries.

The structure of the Baucus proposal is fundamentally sound:

—that the trade imbalances of the two countries must be addressed by changes in the macroeconomic policies of both, along with achievement and maintenance (via a target zone) of an appropriate yen-dollar exchange rate;

—that the disputes over trade barriers need to be handled through trade negotiations; and

—that international burden sharing needs to be addressed comprehensively and systematically.

The question is whether these objectives can be pursued more effectively in a bilateral or a multilateral framework. The confusion between the macro and micro issues in much of the policy debate, in particular, is an important element in answering the question.

On the macroeconomic/monetary issues, an informal "G-2" already exists to a degree.[3] As the economic and financial ties between the world's largest creditor and debtor countries deepens, such a relationship will become increasingly important. Further institutionalization would be beneficial *if* (1) it would help galvanize domestic support within each country for the needed policy changes, notably reduction of the budget deficit in the United States and continued rapid growth of domestic demand in Japan, (2) it could be done without jeopardizing the cooperation of other key countries, notably in Europe, and (3) it would help avoid destructive policies on the sector-specific front.

We are skeptical that formalizing the G-2 would enhance the prospects for better macro policies. Japan is already doing most of what the United States has asked of it, at least for now, and we find it hard to believe that such a pact would suddenly resolve the budget debate here. The United States and Japan might be able to take a bilateral lead in establishing more extensive target zone arrangements, as they did in constructing the present "reference ranges" (with the Baker-Miyazama accord of October 1986) but such arrangements should be implemented only after the needed macro changes (and further depreciation of the dollar) have been put in place.

As to the effects on the rest of the world, a macro-monetary G-2, unlike an FTA in trade, would not discriminate against other countries. Hence it should not be objectionable in any tangible sense, although some other countries (as in late 1986) would clearly resent the United States and Japan "going it alone" on such key issues. The right answer is to try to proceed multilaterally on the macro/monetary issues as much as possible, but for the G-2 to be prepared to advance on its own if other countries try to block progress for excessive periods of time.

The most difficult aspect of the issue is its relationship to traditional trade policy concerns. On the one hand, institution of a G-2 on macro/monetary problems might provide a framework for US-Japan relations which would facilitate better handling of trade policy problems—thereby reducing the risk of counterproductive protectionist steps in both countries. The super 301 process and other bilateral negotiations would be cast in a less contentious framework. On the other hand, inclusion—or even serious negotiation—of a G-2, even if aimed at macro-monetary issues, could add substantially to the psychology cited above: the presumption that the world was heading toward regional blocs, resulting in a scramble by others to join (several East Asians) or to strengthen their own counterweights (the EC, already headed toward 1992) A bilateral economic pact between the world's two economic superpowers, even if addressed primarily to macro/monetary issues, would cast a broad shadow over the multilateral system.

In addition, the trade policy component of Senator Baucus' proposal has one troubling aspect. It supports a series of market-share targets (as with the 1986 semiconductor pact) to help meet its trade-balancing objectives. Our view is that market-sharing agreements would be extremely counterproductive for the United States. The US experience under the semiconductor precedent cited by Senator Baucus (along with its steel and auto precedents) provides evidence of why this is so.

In essence, such market-sharing agreements (1) force Japan to cartelize the industry in question to meet the agreed targets; (2) thereby greatly *strengthen* the hand of MITI and "Japan Inc."; (3) transfer billions of dollars of windfall profits to our toughest competitors by enabling them to jack up the prices we pay; (4) reduce the competitive pressure on our own producers in the short run while we disadvantage US consumers of the affected products (including other US industries, such as computers in the semiconductor case) and (5) most generally, engage the United States in a type of contest which we, with our highly pluralistic society as opposed to Japan's homogeneity, are almost certain to lose.[4] In other words, the United States has a comparative disadvantage in managing trade. Hence we would strongly oppose this element of the Baucus proposal.

It would be desirable to construct a new dispute settlement process that would permit individual trade issues to be handled in a less politicized manner, however, if one could be developed outside the framework of a substantive agreement like the FTA with Canada. An objective and credible procedure to settle disputes obviously helps, and the precedent of binding arbitration in the US-Canada pact could be usefully explored. Two questions would need to be addressed in this regard. Would the United States agree to binding arbitration in cases with Japan that likely would involve bigger stakes than those that arise in the US-Canada context? And how could one ensure the consistency of US-Japan rulings with US-Canada rulings?

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[3] The original proposal for such an accord appeared in C. Fred Bergsten, "Economic Imbalances and World Politics," *Foreign Affairs*, April 1987.

[4] C. Fred Bergsten, Kimberly Ann Elliott, Jeffrey J. Schott, and Wendy E. Takacs, *Auction Quotas and United States Trade Policy*. Washington: Institute for International Economics, September 1987.

As to burden sharing, a serious US-Japan dialogue is needed on where and how to translate Japan's increased economic and financial capability into responsible global leadership. The great merit of the Baucus proposal in this area is that it would draw together the various elements of the issue—including military spending, aid, and debt relief for the Third World. We believe that Japan is prepared to do much more in these areas if the United States approaches it coherently and accords it increased international responsibility—such as the second largest quota in the IMF, and perhaps the Presidency of the World Bank—in return.[5]

Our conclusion is that the United States should greatly intensify its bilateral efforts with Japan in each of the three areas proposed by Senator Baucus, developing a unified and consistent position across these topics and presenting a cohesive policy on them. However, we would not at this time opt for a *comprehensive* bilateral accord to implement such a policy. Rather we would pursue each of the three sets of goals separately—essentially via Treasury and the Ministry of Finance on macro/monetary issues, via the USTR and MITI on trade policy, and via the State Department and Ministry of Foreign Affairs on burden sharing—and without constructing a permanent new institutional structure.

This would require close coordination and setting of priorities within the two governments, a virtue of such an integrated approach. It would avoid spending a great deal of time on form rather than substance, at a time when it is urgent to achieve tangible results. It would avoid the risk of jeopardizing the prospects for multilateral cooperation, and adding to the appearance (and perhaps the reality) of further movement toward regional blocs, which concerns us so much.

Interpreted and implemented in this way, the Baucus proposal could thus provide a unifying theme and overarching purpose for the conduct of US-Japan relations over the next few years. We believe it should be pursued, and are pleased to have this opportunity to discuss it.

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[5] Specific proposals in this regard are set out in C. Fred Bergsten, *America in the World Economy: A Strategy for the 1990s*, chapter 7.

An effective American trade policy will come from recognizing the

Tailored Trade: Dealing

by PAT CHOATE and JUYNE LINGER

The United States is floundering in the global marketplace, incurring devastating losses in market position, profits, equity, and jobs. The real problem is less with America's products than it is with America's trade policy. We face the prospect of continuing economic loss until American business and political leaders recognize the fundamental differences between U.S. and foreign economic systems. Today the key trade issue is not free trade versus protectionism but diminishing trade versus expanding trade.

We are operating with an obsolete American trade policy, an artifact of the mid-1940s when the United States and Britain dominated the global economy, tariffs were the principal obstacle to trade, and U.S. supremacy was uncontested in virtually all industries. In the intervening decades, economic circumstances have shifted radically. United States trade policy has not.

Today America's trade policy seems frozen by intellectual and political inflexibility, paralyzed by the relentless conflict between proponents of "free" and "fair" trade. The free traders argue that American markets should be open, and the movement of goods and services across national borders unrestrained. The fair traders assert that access to American markets should be restricted until U.S. businesses are granted equal access to foreign markets. They contend that free trade is impossible as long as other nations erect barriers to U.S. exports.

Of course, both are correct: fair trade requires equal access and equal access leads to free trade. The problem is that both sides base their positions on the same two long-held and now outdated premises:

1. Global commerce is conducted under the terms of the General Agreement on Tariffs and Trade (GATT) and dominated by the United States and similar economic systems abroad.
2. Multilateral negotiations are the most effective way to resolve pressing trade issues.

Both assumptions are wrong. The 40-year-old GATT now covers less than 7% of global commerce and financial flows. More important, world trade is no longer dominated by the free-trade economies. Today, nearly 75% of all world commerce is conducted by economic systems operating with principles at odds with those of the United States (see *Exhibits*).

The loss of dominance by the free-trade economies must bring a dramatic shift in the overall goal of U.S. trade policy. The United States has long operated on the premise that a multilateral world requires multilateral negotiations. But reliance on multilateral negotiations has become a risky proposition at best. The bulk of U.S. trade negotiating efforts over the past four decades has taken place in multilateral talks under the auspices of the GATT (see insert "A Look at the GATT"). Indeed, U.S. policymakers have mistaken the GATT negotiation process for an end in itself. Making the GATT work has become an American trade objective. But as the number of GATT signatories has more than quadrupled from 23 countries in 1948 to 94 today, the task of forging a multilateral trade policy consensus has become virtually impossible.

The new players – all with their own trade objectives and most with economic systems unlike Uncle Sam's – are often reluctant to engage in substantive multilateral trade negotiations. When nations finally do confer, moreover, new rules come slowly: the Tokyo Round of trade talks began in 1973 and did not end until 1979.

While multilateral talks drag on, the United States misses opportunities for international economic cooperation and trade expansion. The new reality is that a multilateral world requires more options, both inside and outside the GATT, than multilateral negotiations provide.

Of course, a new trade strategy alone will not ensure U.S. success in the fast-paced, competitive global marketplace of this century and the next. The economic future of the United States depends on two linked economic agendas: one internal, the other external.

The internal agenda would focus on the competitiveness of American industry – on creating an economic environment in which business, workers, and

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different economic systems in the world.

with the World as It Is

unions can combine to turn out products that are competitive in price, quality, service, innovation, and marketing. This agenda would require changes in macroeconomic and microeconomic policies: reducing the federal budget deficit, lowering the cost of capital, reducing pressures for quick results and short-term earnings, rebuilding the public infrastructure, commercializing new technologies, and upgrading the competence of American workers.

The external agenda would focus on expanding trade. That agenda demands a more practical, less ideological national trade strategy. Its first requisite is a pragmatic approach for dealing with foreign economic systems and competitive practices that are often vastly different from those of the United States. Its second is a negotiating strategy that will give America the means and flexibility to expand commerce with other nations by dealing with them as they are, rather than as we wish they were.

Five Competing Economic Systems

America's involvement in the global economy has passed through two distinct periods: a development era during which the United States sought industrial self-sufficiency in the eighteenth and nineteenth centuries, and a free-trade era in the early- and middle-twentieth century during which open trade

The Five Systems of Global Trade

● Anglo-American
● Centrally Planned
● Developing
● Mixed
● Plan-Driven

ELIOT BERGMAN

GATT describes a black and white world of trade: free trade versus protectionism. But the five systems shown on this map paint a far different picture. The Anglo-American system represents a distinct minority of the world's trading systems.

A Look at the GATT

The General Agreement on Tariffs and Trade (GATT) is the principal multilateral agreement covering world trade. Its purpose is to foster unrestricted multilateral trade by binding participating nations to negotiate trade rules and by mandating penalties for any deviation from these obligations. In June 1987, 94 nations were contracting parties to the GATT, which is administered by a secretariat of 350 headquartered in Geneva. Its budget for 1987 is SFr 61,122,300 – approximately $40 million. The GATT has many fundamental flaws, most of which can be traced to its origins.

Immediately following World War II, the United States championed the creation of a global economic system which rested on the World Bank, the International Monetary Fund (IMF), and the International Trade Organization (ITO). The ITO was to be a supranational organization that would deal with global trade in its entirety – imports, exports, adjustment, employment, and differing economic practices. The United States envisioned an ITO with substantial powers, much like the IMF, to confront nations that refused to eliminate trade-distorting barriers and practices.

Beginning in 1946, 23 nations began negotiating a charter for the ITO. As part of a larger effort, these nations also began multilateral negotiations in the summer of 1947 to reduce tariffs. It was anticipated that this agreement would be folded into the ITO. The tariff treaty was completed in January of 1948 and the participating nations became signatories to the GATT. By the end of 1948, the negotiators for the 23 participating nations completed the ITO charter, later called the Havana Charter, and referred it for the approval of their governments.

The ratification of the ITO, however, became embroiled in American politics and was rejected by the Congress. The residual was the GATT "interim" agreement. By default, therefore, the GATT became the principal multilateral agreement on global trade.

As a tariff accord, the GATT was fine. As the foundation for global trade, it is fundamentally flawed. Specifically, GATT coverage was limited to merchandise trade and tariffs. Because it was a contractual agreement, enforcement depended on the voluntary arbitration of disagreements between signatories.

To remedy these deficiencies, the United States has led other nations in six additional GATT negotiations – in 1949, 1951, 1956, 1960-62, 1962-67, and 1973-79. The eighth and most recent series of negotiations, the Uruguay Round, was begun in 1986. Most striking about these negotiations is that the time lag between each has grown, while succeeding negotiations take longer to conclude. If the past is a guide to the future, the Uruguay Round will not be completed until the mid-1990s.

Now as in the past, the GATT has four principal limitations. First, it neither recognizes nor bridges the vast differences between the world's five economic systems. Rather, the basic goal of the GATT is to advance free trade and open markets through the reduction of market-retarding obstacles.

Second, GATT coverage is limited. The GATT covers roughly 80% of world trade in merchandise. However, trade in services, agriculture, textiles, and investment and capital flows are presently excluded. Consequently, the GATT only covers 5% to 7% of global economic activity.

Third, the GATT dispute-settlement mechanisms are ambiguous, slow, and unenforceable. For example, the United States pleaded unsuccessfully for 12 years for the European Community (EC) to reduce its import barriers to American citrus. In 1982, the United States took the issue to the GATT; in 1985, a GATT panel found in favor of the United States; the EC ignored these findings, precipitating a minor trade war. This example is so common that most nations are unwilling to involve the GATT in trade disputes.

Finally, and as a direct result of its other weaknesses, the GATT's low credibility limits its capacity to correct the global trade system's weaknesses. Furthermore, its existence hampers the creation of alternatives. Indeed, GATT's inability to change has made the agreement not merely an obstacle, but a threat to expanded world trade.

was linked with prosperity. Now America has entered a third, more dangerous era – an age of global economic interdependence.

Today, as most business leaders will readily attest, everything is globalized. Finance. Technology. Research and product development. Customer service. Capital and investment flows. Production facilities. Distribution networks. Marketing.

With surprising swiftness, the United States has shifted from relative economic self-sufficiency to global interdependence. In 1960, trade accounted for only 10% of the country's GNP. By the mid-1980s, that figure had more than doubled. American farmers now sell 30% of their grain production overseas; 40% of U.S. farmland is devoted to crops for export. In fact, more U.S. farmland is used to feed the Japanese than Japanese farmland. American industry exports more than 20% of its manufacturing output, and one out of every six manufacturing jobs depends on foreign sales. Within the U.S. market, more than 70% of American industry now faces stiff foreign competition.

But while the economy has been changing its course and business leaders adjusting their practices, American trade policies remain locked in the past. U.S. trade policy still rests on three pillars:

1. Open markets and free trade are the most efficient means to expand global trade and, therefore, should form the economic model that guides world commerce.
2. Multilateral negotiations are the best means to open markets and promote free trade.
3. The United States has a primary responsibility among nations to advance free trade.

There is, however, a fundamental flaw in this thinking: other nations' economies are not like the United States' economy, nor will they be, nor should they be. Other countries compete in the world marketplace using vastly different assumptions, serving vastly different ends than America's. Economic systems differ in ways both manifest and subtle, reflecting basic differences in history, culture, national aspirations, and politics.

Five types of economic systems confront the United States. Four of them are not founded on our free-trade economic model: centrally planned (like the Soviet Union); mixed (France); developing (Mexico); and plan-driven (Japan). Only the Anglo-American system is rooted in a free- and fair-trade approach.

Within this framework, there are, of course, variations. The mixed economy of France differs in many ways from the mixed economy of Sweden; Japan's version of a plan-driven system differs from South Korea's plan-driven economy; and even between America and Canada there are clear distinctions. Yet each model possesses characteristics that are important to the design of future U.S. trade policies. It is possible, for example, to sketch the differences among the five systems by comparing them along four dimensions: the role of government in the economy; the ownership of industry; the relationship between process and results in the system; and how trade is conducted.

In the rule-driven, market-oriented Anglo-American economic model, for instance, government sets the economic backdrop but takes few direct positions on which industries should exist, grow, or decline. In contrast, plan-driven economies, like Japan's, and mixed economies, like Sweden's, skillfully blend the strength of government with the flexibility of the marketplace. Once decisions are made, government backs them with resources and, at strategic moments, with trade protection.

In free-market and plan-driven economies, private ownership of business and industry is the rule. The mixed economies, like France's, are based on a combination of state and private ownership, market and nonmarket decisions. Major industries are either owned by the state or tightly regulated. The major enterprises in the centrally planned economies, of course, are state owned.

The Anglo-American economies are process oriented; once rules are established, market processes dominate. The plan-driven economies are results oriented; business and government shape a national "vision" that often includes targeting certain industries like semiconductors or computers. To guide the economy toward desired results, governments of plan-driven economies will provide special financing, encourage joint research, and offer adjustment assistance like worker retraining. The mixed economies rely on a combination of market processes and government planning. The command economies are dominated by state planning.

The process-oriented Anglo-American economies are heavily influenced by economists and lawyers who make, interpret, and enforce the rules under which market processes operate. Because the plan-driven economies are results oriented, they have far less need for lawyers and economists to make and enforce rules. As recently as the mid-1970s, Japan's huge Ministry of International Trade and Industry had only two Ph.D. economists. Instead, politicians and business leaders direct the results-oriented economies. In trade talks, therefore, U.S. and Japanese trade negotiators often have different orientations: the Americans focus on rules that will facilitate market processes while the Japanese focus on measures that can advance their national economic vision.

> In the U.S. system, economists and lawyers dominate – but not in Japan.

Negotiations are handled differently in the different systems as well. In the Anglo-American economies, trade is conducted mainly by business. In the mixed and planned economies, trade often involves negotiations with both business and government. In the centrally managed economies, the government alone conducts trade.

Even the vocabulary of trade is dramatically different; in centrally managed economies, the concept of trade liberalization means increasing the number of government agencies that can negotiate their own trade arrangements. Under Mikhail Gorbachev's program of *glasnost*, for example, the Soviet Union's Ministry of Foreign Trade must share its monopoly over trade negotiations with 21 other ministries and 72 state enterprises, each of which can now make its own trade deals. But even under trade liberalization, in all cases trade is still with the state.

In fashioning their economic systems, the developing nations have borrowed from each of the other four systems, patching together combinations of public and private sector initiatives. In virtually all these countries, however, government predominates in designing and implementing a national trade strategy.

American policymakers, devoted to free trade and open markets, have ignored the often vast differences between U.S. and foreign economic systems. Rather, they still operate on the free-trade premise that policies that are neutral to the fate of American industries will produce the same market-oriented benefits globally as they do domestically. Consequently, American trade policies are doing enormous harm to U.S. industry.

Even where there is ample evidence of harm – as in the case of consumer electronics – industries have been unable to get relief from predatory foreign practices like dumping, theft of American intellectual property, foreign regulation that forces U.S. companies to move plants and jobs offshore as a condition of market entry, and nontariff barriers that restrict exports of America's most competitive goods and services. Free-trade advocates have exacerbated the problem of gaining legitimate relief by discrediting reciprocal market access as a negotiating strategy. And they mistakenly brand tough negotiating tactics as protectionism.

> America's system would never fit many other nations – and they know it.

Multilateral negotiations via the GATT have been unable to bridge the differences among the world's five economic systems. If we continue to depend on these agreements, the United States must resign itself to failure: we will effect no major changes in the global trade system by the end of the 1980s. And by then the cumulative U.S. trade deficit for the decade is likely to exceed $1 trillion.

Despite America's spirited urging of other nations to adopt the U.S. economic model – reliance on market forces, free trade, and deregulation – this system has enjoyed little appeal abroad. It suits us, but it would never fit many other nations – and they know it. Consequently, U.S. trade policy is at a crossroads: we can either continue to urge other nations to adopt our free-trade economic model or we can change U.S. trade policy to deal with other nations as they are, rather than as we wish they would be.

Clearly, only the second course makes sense. It is pure folly for us to presume that we can somehow convince other nations to abandon economic systems that serve their interests and adopt a system that serves ours. Nor can we blindly continue to look the other way. America can no longer afford its missionary work on behalf of global free trade. When the United States had huge trade surpluses and was the world's largest creditor, we could afford to give other nations special trade concessions as a means of inducing them to become free traders. But now that the United States has chalked up an unprecedented $400 billion in indebtedness and faces unprecedented trade deficits far into the future, a "beggar thyself" policy to help our neighbors is impractical. We need a new U.S. trade strategy.

Shifting to Tailored Trade

To meet the challenges of global competition, the United States must have trade-sensitive fiscal, monetary, and exchange-rate policies. And the government must vigorously enforce domestic trade laws. But while these actions are necessary, by themselves they are not sufficient to reverse America's trade losses. Beyond sound macroeconomic policies and the production of fully competitive goods and services, America also requires results-oriented trade policies to:

Deal effectively with foreign economic systems and competitive practices that are quite different from its own.

Resolve trade disputes in a timely manner.

Address trade comprehensively – imports, exports, investment, and competitive practices.

There is a recent benchmark for such a strategy: the newly negotiated U.S.-Canadian bilateral trade pact. This agreement – a strong sign that the otherwise arthritic U.S. trade strategy may have some flexibility – has produced a sweeping change in the trade arrangements between the world's two largest trading partners. It created a framework and time schedule for eliminating tariff and nontariff trade barriers between them. Moreover, the U.S.-Canada talks were completed in less than 16 months, breakneck speed for trade negotiations. And they were comprehensive, covering imports, exports, and investment.

At the same time that the two nations established a larger framework for their bilateral trade, they addressed and partially resolved several thorny micro issues, such as the 1965 Automotive Products Trade Agreement and Canadian restrictions on U.S. investment. Finally, and perhaps most important, the agreement established a powerful and quick dispute-settlement mechanism, based on arbitration panels composed of experts.

The U.S.-Canadian trade negotiations illustrate what bilateral arrangements can produce. Because U.S. trade policymakers have been fixated on a multilateral strategy, other trade expansion possibilities have been relegated to a secondary status, constrained in scope, or used as a placebo for powerful U.S. interests. The recent Market-Oriented Sectoral Specific (MOSS) negotiations with Japan, for example, concentrated on a narrow range of goods and services, like easing restrictions on U.S. lawyers practicing in Japan.

Bilateral arrangements have their limitations, of course. They would expand trade, for example, but only between the participating countries. Moreover, a system of global trade based exclusively on bilateral or "plurilateral" (involving several nations with mutual interests) relations could easily create so much fragmentation and discrimination that net global trade would be reduced.

When carefully drawn, however, bilateral or plurilateral arrangements can also facilitate the expansion of trade. Such arrangements are quite common; most other nations conclude them as a matter of course. As the U.S.-Canadian agreement illustrates, these agreements have great potential for expanding U.S. trade.

A tailored-trade approach would elevate bilateral and plurilateral negotiations from a secondary to a primary role. This would enable American representatives to match the negotiations to the economic system with which we were negotiating. For example, talks would draw free-trade arrangements with free-trade economies, managed-trade agreements with managed-trade economies, and appropriately tailored, mixed agreements with those economic systems in between. At the same time, there are some crosscutting issues, such as improved protection of intellectual property rights, that need to be negotiated across the five economic systems in either a plurilateral or multilateral forum.

Non-Anglo-American systems account for 73% of world trade…

(in millions of current U.S. dollars)

Economic System	*Total Value*	*Percent of World Trade*
Anglo-American	1,062,759	27
Centrally Planned	464,439	12
Developing	575,957	15
Mixed	1,297,263	33
Plan-Driven	527,957	13
Total	3,927,987	100

Source: Calculated from merchandise trade data in the World Bank's *World Development Report 1986* (New York City: Oxford University Press, 1987) and the CIA's *Handbook of Economic Statistics 1986* (Washington, D.C.: Central Intelligence Agency, 1986).

A tailored-trade approach would be pursued through a parallel negotiation strategy using governmental structures and holding concurrent discussions with any nation willing to join in. The United States would, in effect, announce that its door is open to all countries ready to bargain. A parallel approach in which talks can proceed bilaterally, plurilaterally, or multilaterally gives the United States the flexibility to negotiate with cooperative trading partners, even if some nations refuse to participate. The momentum created by parallel negotiations represents a formidable incentive for uncooperative nations to end their delaying tactics and participate in trade talks. Very simply, those nations that participate earn the benefits.

…and 67% of world GNP

(in billions of current U.S. dollars)

Economic System	*Total Value*	*Percent of World GNP*
Anglo-American	4,384.1	33
Centrally Planned	1,857.4	24
Developing	2,524.5	14
Mixed	1,310.5	19
Plan-Driven	4,384.1	10
Total	113,179.9	100

Source: Calculated from data in the U.S. Arms Control and Disarmament Agency's *World Military Expenditures and Arms Transfers 1985* (Washington, D.C.: ACDA Publication 123, 1985) and the CIA's *Handbook of Economic Statistics 1986*.

The major benefit, of course, is access to the U.S. market. Ironically, the massive trade deficit that compels the United States to reform its trade policies also generates enormous negotiating leverage; America is the largest market for dozens of nations. The threat to close U.S. markets to nations unwilling to open their markets to American goods, services, and investment is the best–perhaps the only–negotiating chip the U.S. possesses. Any meaningful, self-interested U.S. trade policy must use this tool to expand market access for nations that do negotiate trade expansion agreements and limit market access for nations that do not.

> Those nations that agree to negotiate earn the benefits of the U.S. market.

To be sure, America must not succumb to the lure of old-fashioned protectionism: there will always be those who would rather erect barriers to foreign goods and services than improve their own ability to compete. At the same time, U.S. policymakers must be sophisticated enough to discern the difference between closing U.S. markets to avoid foreign competition and threatening to close them as a device to open foreign markets. The former shrinks trade, the latter expands it. Our national interests lie with expanded trade. But in a more complex world of competing economic systems, a sophisticated negotiating strategy must recognize that the path to our ultimate goal is rarely straight. In fact, sometimes it may even appear to point in the opposite direction, away from expanded trade, as a way of finally reaching the desired destination.

Top priority should go to the most pressing trade issues. Almost two-thirds of the U.S. trade deficit in recent years has been with Canada, Japan, South Korea, Taiwan, and Germany. It is only common sense that we seek bilateral negotiations with these countries. Rather than wait for cumbersome multilateral talks to grind forward, the United States should quickly seek direct negotiations aimed at reducing current imbalances. The Canadian pact shows that this approach will work. And it should show the other countries that agreement has benefits.

While the goal of a tailored-trade strategy will always remain the same–to expand trade–the focus and negotiating tactics will vary from one economic system to the next. The primary focus of tailored-trade negotiations with free-trade economies, for instance, is to open markets. These negotiations seek to eliminate obstacles that impede market transactions: tariffs, subsidies, nontariff barriers, and performance requirements, for example. By improving the market processes in the free-trade economies, trade can be expanded between these nations.

Tailored-trade negotiations with the plan-directed economies, such as Japan's, would be results oriented, concentrating on outcomes, timetables, and responsibilities. These talks would focus on a wide array of issues including levels of permissible trade imbalances, the composition of trade, allowable market shares, investment in both countries, and practices like dumping in third markets.

Negotiation with the plan-driven market economies, particularly Japan, South Korea, and Taiwan, is essential because those nations are both the most secure U.S. allies in the Pacific and among the principal sources of U.S. trade deficits. They are also America's main economic competitors and popular models for the economic policies of other nations. Together they represent the second-largest market in the world. American companies cannot hope to compete successfully in the global marketplace if they cannot penetrate these plan-driven markets while rival companies based within those countries continue to enjoy unrestricted access to the American market.

Tailored-trade agreements with the mixed economies will focus on a combination of market-opening processes and results-oriented outcomes. These negotiations are timely since many of the European countries have become increasingly nationalistic, retarding foreign investment and imports to shield their domestic markets and champion companies. Indeed, the largest of these economies, the Federal Republic of Germany, has shrunk from either engaging in GATT negotiations or helping the United States give macroeconomic stimulus to the global economy. Using the carrot and the stick of the U.S. market, we can remind the Germans that they share responsibility for world economic growth.

> American companies can't compete if foreign markets remain closed and the U.S. market stays open.

Tailored-trade talks with the command economies will attempt to establish managed-trade arrangements. While trade with the command economies offers many theoretical possibilities, there are formidable obstacles. For more than a decade, American companies have looked at the People's Republic of China as a tremendous market. But U.S. companies that invest in China have no protection except their contracts. U.S. sales to the Soviet Union are limited by Soviet insistence that foreign companies take all or partial payment through countertrade, such as exchanging capital goods for oil and gas. To gain foreign currency, the command economies often dump their products on world markets, thereby undercutting competitive U.S. companies. Before trade with the managed economies can expand much, these and dozens of other critical issues must be resolved.

Tailored-trade agreements with developing nations would involve a combination of market-opening processes, results-oriented arrangements, and managed trade. This reflects the mix of economic systems, often within one nation, used by the developing countries. Of these negotiations, the most important are with Mexico, a nation deeply mired in debt, economic stagnation, and fast population growth.

Tailored-trade agreements need to be supplemented by negotiations on crosscutting issues, problems that are part of the current global economy regardless of economic system. Counterfeiting, for instance, concerns several advanced industrial nations, including Britain, Japan, and Sweden, each of which operates with a different system. Another worry is the burgeoning number of offset requirements – arrangements that vary in complexity from barter requirements to complicated coproduction and technology transfer requirements. Plurilateral negotiations are best for addressing such issues.

If there is a future for the GATT, it is as a second-tier forum in which to resolve issues like these. There will always be problems of definition – what constitutes a government subsidy, for example – which can be tossed to the GATT to handle. But the United States ought not to deceive itself about the future role of the GATT or the best way to represent America's interests in the global economy. A tailored-trade strategy can give America the means and flexibility to expand commerce with other nations by bridging economic differences and making U.S. trade policy far less ideological and far more practical. ⛉

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PREPARED STATEMENT OF DORAL S. COOPER

I. INTRODUCTION

Good morning, Mr. Chairman and members of the Committee. I appreciate the opportunity to appear before the Committee today to discuss free trade area agreements. My name is Doral Cooper. I am President of C&M international Ltd., an international trade and business consulting firm. Although C&M International represents countries in the Pacific Rim, I am appearing today on my own behalf as an expert witness. I was formerly the Assistant U.S. Trade Representative for Asia, Africa and the Middle East, and in that capacity was the chief negotiator for the United States for the U.S.-Israel Free Trade Area Agreement. I want to share the history of that experience with you today as well as my opinion that FTA agreements offer the United States an opportunity to achieve specific trade policy goals in an efficient and effective manner as well as the opportunity to reassert our leadership role in the formulation of international trade policy.

II. THE U.S.-ISRAEL FTA

I will begin with background on the genesis of the U.S.-Israel FTA. While historically the United States negotiated liberalization of tariff and nontariff barriers to trade on a multilateral basis, other countries have negotiated numerous comprehensive bilateral trade agreements. The U.S.-Israel FTA was the first such agreement negotiated by the United States.

The Government of Israel suggested an FTA to the United States in 1981. The U.S. Government was at first reluctant to pursue the suggestion because the United States had never before negotiated a bilateral FTA, and was historically and philosophically committed to the multilateral process. However, multi-country negotiations of the General Agreement on Tariffs and Trade (GATT) had become increasingly complex, time-consuming, and, most importantly, slow to achieve the kind of far-reaching results the U.S. Government anticipated and the U.S. economy required. In addition, the multilateral system was not addressing many issues of keen importance to the United States, such as trade in services, investment, and the protection of intellectual property rights.

The major debate surrounding the possible commencement of the FTA negotiations with Israel was very similar to debates which have been held subsequently concerning the negotiation of additional FTA's, and to the examination of the issue here this morning. Should the United States embark on a course of comprehensive bilateral negotiations? Would such a course spell the end of the multilateral system?

Numerous, long and often acrimonious inter-agency discussions were held on this very subject, including two Cabinet meetings, prior to the start of negotiations with Israel. In the end, it was decided to move forward for the following reasons. First, the FTA negotiations would not replace GATT; in fact, FTA's are sanctioned by the GATT in Article XXIV. Second, FTA negotiations would provide a model for trade liberalization for the rest of the international trade community, and would allow the United States to introduce—in a concrete way—those "new" subjects of international trade negotiations increasingly important to American exporters: services, investment and the protection of intellectual property rights. And third, an FTA with Israel promised many economic benefits for U.S. exporters and investors. The reasons that gave rise to the U.S.-Israel FTA are no less true today than they were in 1982.

Another part of this brief history is important to our discussions today. The U.S.-Israel Free Trade Agreement was meant to be a model for additional agreements to follow. In fact, before the negotiations with Israel began, an offer was extended to Egypt to negotiate a similar accord when and if that country was ready. And, as hoped and expected, the agreement with Israel provided the foundation for the successful FTA negotiations with Canada covering trade in services, lowering barriers to investment, and addressing intellectual property rights protection.

As expected, the U.S.-Israel FTA Agreement has had a significant positive impact on U.S.-Israeli trade and investment. The FTA became effective on September 1, 1985; from 1986–87, U.S. exports to Israel increased 18 percent, and by another 17 percent in 1988. U.S. investment in Israel also has expanded. Numerous U.S. companies have established or expanded existing manufacturing operations in Israel, including Mast Industries, Intel, National Semiconductor, Motorola, Sara Lee, Fibronics International, KLA Instruments, and others.

III. FTA'S AND THE GATT

Some observers argue that FTA's would undermine the GATT system. However, most experts agree that bilateral free trade arrangements in fact complement multilateral trade liberalization efforts. Arthur Dunkel, Director General of the GATT, recently commented that the GATT has always considered bilateral agreements as "a way to move things forward. . . . The two processes [bilateral and multilateral trade liberalization] are totally complementary." The leaders of the seven major industrial countries (the so-called G-7) in their communique issued at the close of the Toronto Summit welcomed both the U.S.-Canada FTA as well as the steady progress of the EC toward full integration in 1992. They noted: "It is our policy that these developments, together with other moves towards regional cooperation in which our countries are involved, should support the open, multilateral trading system and the liberalizing impact of the Uruguay Round."

The General Agreement itself specifically sanctions free trade area agreements. Article XXIV authorizes Contracting Parties to enter into FTA's as long as those agreements liberalize "substantially all" trade between the negotiating parties. In Article XXIV(4), the Contracting Parties "recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to the agreements.

FTA's are not designed to, nor do they have the effect of, replacing the GATT system. They can, however, act to spur needed changes in the multilateral trading system. Increasingly, questions are being raised about the adequacy of the multilateral framework governing international trade. Multi-country negotiations have become enormously complex, time-consuming, and slow to achieve the kind of far-reaching results the U.S. Government desires and the U.S. economy requires. In addition, the multilateral system still has not addressed in any meaningful way many issues of keen importance to the United States, such as trade in services, investment, and the protection of intellectual property rights. Many members of the GATT are unwilling to liberalize their trading regimes further or to extend disciplines on unfair trading practices to the new areas of interest to the United States. Bilateral FTA's can serve as a much-needed catalyst to invigorate the multilateral trading system. Fear that they may be left behind will stimulate countries to participate in both bilateral and multilateral negotiations with the United States and to get serious about reducing trade barriers.

It cannot be said that either the U.S.-Israel Agreement or the U.S.-Canada Agreement has weakened the GATT system. Indeed, I firmly believe they have encouraged the multilateral system to reach for higher, improved levels of trade liberalization than otherwise would have been possible. They have also provided very significant political benefits to the United States by signalling to the rest of the world that we will not allow the dialogue in international trade negotiations to be dictated by the lowest common denominator of agreement, that we will re-exert our leadership in the GATT and elsewhere through the example of liberalized bilateral trade, and that we welcome the challenge of trading with any country openly and fairly, on the basis of reciprocal market access.

IV. ECONOMIC BENEFITS

The U.S. economy is the largest, most open economy in the world. Therefore, the relative costs to the United States of reducing tariffs and nontariff barriers as part of a bilateral free trade area agreement generally are relatively small. In contrast, the benefits are very considerable. First, since free trade area agreements are reciprocal, other countries are required to eliminate tariff and nontariff barriers which are frequently much higher than those of the United States. Therefore, U.S. exporters benefit at relatively little cost to U.S. producers.

Second, since the tariff and nontariff barrier reductions negotiated under an FTA are only available to the countries participating in the trade liberalization, the United States will enjoy a margin of preference for its exports to FTA partners. This will mean that our negotiators will not be liberalizing international trade for the benefit of the exports of our major Asian and European competitors.

V. TRADE POLICY BENEFITS

At one time, the United States was the unquestioned leader of the world trading system and the GATT. As such, it could essentially dictate GATT policy and ensure the implementation of trade liberalizing measures. Today, that position has changed markedly. The European Community, Japan and others are now powerful influences whose ideas regarding international trade rules often differ considerably from those of the United States. Developing countries are increasingly acting as an effective block to push their own trade agenda on such topics as tropical products, textile trade liberalization, and "special and differential treatment".

The United States needs to re-exert its leadership role in the world trading system. FTA's provide this opportunity by showcasing new trade concepts and approaches that can be used as precedents for later implementation in the multilateral arena. For example, certain important developing country leaders in the GATT refuse to negotiate on the issue of services or intellectual property rights protection at the GATT. Multilateral negotiations on these issues would move forward more smoothly if the United States could show that provisions in the U.S.-Israel and U.S.-Canada FTA's work.

In general, the "moderate newly industrializing countries (NICs)" (and in this group I include the Asian NICs) recognize and appreciate, like the United States, that the Uruguay Round is too important for the future of the international trading system to fail, and therefore it will not. Simply put, too much is at stake. This group generally appreciates that the major "new" issues being discussed in Geneva are of immense economic (and political) interest to the United States. That said, most of these countries have an interest in providing for firm international trading rules in the areas where they are becoming competitive, such as trade in services and international investment. In addition, the fact that they rely heavily on the inflow of foreign investment and technology to support their internal economic growth rates means that they must be concerned about the protection of intellectual property. Negotiation by the United States of additional FTA's, with these countries or others in the Pacific Rim, will not cause them to lose faith in the GATT system and abandon it for regional trading blocs.

VI. FTA'S AND THE PACIFIC RIM

The countries of the Pacific Rim have experienced considerable growth recently, growth that bodes well for increasing U.S. exports. In Taiwan, the real gross national product grew at an average rate of 8 percent in the 1950s, 9 percent during the 1960s, 10 percent during the 1970s, and 11 percent in 1986 and 1987. In Korea, real gross domestic product grew 12 percent in both 1986 and 1987. Growth in the ASEAN countries has also been considerable. Singapore's real GDP growth was almost 9 percent in 1987, a significant improvement over the depressed level of 1986, which was affected by the 1985-86 recession. Thailand's GDP grew approximately 5 percent in 1986, and 7 percent in 1987. The economies of Malaysia and the Philippines each grew by 5 percent in 1987. Indonesia's real GDP grew approximately 3 percent in 1986 and almost 4 percent in 1987.

In addition to strong economies, the depreciation of the U.S. dollar over the past few years has reduced many of the large trade deficits the United States has recorded with the Pacific Rim countries. By removing the often considerable tariff barriers these countries maintain, FTA's would further benefit American companies trying to sell in these markets. Moreover, a bilateral FTA which eliminated tariffs only on U.S. products should increase U.S. sales in the FTA partner at the expense of other foreign competitors of the United States.

In addition to the strong growth experienced in this region, the countries of the Pacific Rim are economically stable. There is no fear of hyperinflation. The countries generally are well able to service their foreign debts. Their infrastructures are well-developed. Their labor forces are literate, skilled, and inexpensive compared to the United States.

A number of countries in the region have expressed an interest in seriously exploring an FTA with the United States. Indeed, free trade area agreements should be negotiated with countries in the Pacific Rim. These agreements will increase bilateral trade flows. Moreover, because the United States already has extremely low average tariffs, in the short-term at least it is likely to be the greater beneficiary of the mutual elimination of tariff barriers. The U.S.-Israel FTA has increased bilateral trade and investment considerably. All projections for the U.S.-Canada FTA indicate that the resulting increased trade between the two countries would contribute to increased growth in both economies which would not otherwise take place.

VII. CONCLUSION

Not only do FTA's provide tangible benefits, they also demonstrate to a skeptical world (and snail-paced multilateral trade negotiations) the benefits provided by increased trade liberalization. This in itself is a significant benefit of FTA's. The multilateral system is sorely in need of unique, creative solutions to break the current stagnation.

The 1988 Trade Act sent a message to the international trade community: the United States will exercise the leverage of access to its considerable market to open markets overseas. That very negative message, however politically or economically necessary, has caused a growing number of our trading partners to question our leadership in the multilateral trade dialogue and our commitment not only to the GATT but also to the principles of free trade. I would like to suggest this morning that offering these trading partners an alternative in the form of the negotiation of an FTA would make very clear that we are not afraid of fair competition, and would allow the United States to provide positive, forward-looking leadership to the rest of the world.

PREPARED STATEMENT OF GUY F. ERB

U.S.-MEXICAN TRADE AND INVESTMENT AGREEMENTS

For most of the period after the Second World War, U.S.-Mexican commerce developed without a formal governmental framework. The two countries had signed a Treaty of Friendship, Commerce, and Navigation in 1942. But in 1950 Mexico requested the termination of the treaty after an exchange of notes. From that point on, although the U.S. and Mexican governments occasionally established mechanisms for consultation and the resolution of relatively minor points, they did not maintain, let alone improve, their dispute settlement capability. For example, after the collapse of Mexico's negotiations on accession to the General Agreement on Tariffs and Trade (GATT) in 1979, U.S. and Mexican negotiators could not reach an agreement on procedures for the mutual notification of trade policy changes.

Yet in 1987 Mexico and the United States signed a bilateral agreement on trade and investment. This testimony reviews the changes in bilateral economic relations that made the agreement possible, describes the agreement itself, and then examines the options for future bilateral negotiations.

U.S.-MEXICO ECONOMIC RELATIONS

In the period 1972–86, U.S. exports to Mexico grew significantly, particularly in agricultural products and raw materials. Imports of petroleum and, recently, manufactured products from Mexico make this one of the United States' most important bilateral trade relationships. Strong Mexican oil exports and imports during the boom of the late 1970s, then the growth of non-oil exports during the economic downturn of the 1980s, brought Mexico's ratio of trade to GDP to nearly forty per cent by the end of the period, compared to less than 10 per cent in 1972.

Imports of manufactures accounted for over 58 per cent of total U.S. imports from Mexico from 1972–76, but the volume of trade was relatively small and the nature of the manufactured goods relatively simple. As imports of petroleum increased, the share of manufactures in total U.S. imports from Mexico dropped to about 44 per cent during 1977–81. The average stayed at about that level during 1982–86, but reached a high of over 60 per cent in 1986, a year when, for the first time, Mexico recorded a surplus in non-petroleum trade with the United States. Moreover, Mexican manufactured exports now include finished automobiles, automotive parts, and other complex industrial products; current levels of bilateral trade in manufactures are nearly five times those of the 1970s.

The growth of Mexico's in-bond industry has been another striking aspect of the bilateral trade relationship. The number of assembly (or production sharing) plants grew from 350, employing 45,000 workers in 1972, to about 1,100, with 200,000 employees in 1986. Since 1982 the average annual increase in employment in this category of industrial activity has been over 20 per cent; while value added grew from $828 million to about $1.5 billion in 1986, an increase of over 80 per cent. In 1986, only the Mexican oil industry exceeded the earnings from production sharing operations as a source of foreign exchange. One study found that Mexico's production sharing industries directly and indirectly support approximately 3.6 million American jobs in firms that supply the components for assembly plants and related goods and services.[1]

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[1] Michie, Donald A., "The Maquiladoras: A 'Positive' Response to American Business' Lack of Industrial Competitiveness," The University of Texas at El Paso, 1989.

POLICY CHANGES

In early 1985, the President of Mexico, Miguel de la Madrid, signaled his intention to open Mexico's economy. By the end of 1986, Mexico had resolved a longstanding dispute with the United States on subsidies and countervailing duties, joined the GATT, and commenced negotiations with the United States on the bilateral agreement.

The GATT decision was a watershed in Mexico's trade policy and a ratification of de la Madrid's determination to move his country's development model away from import substitution to export-led modernization. The process is not yet complete and remnants of the old trade and investment regime remain in place. Some companies in Mexico have yet to embrace the liberalized system, including a number of foreign firms that entered the Mexican market under market reserve arrangements, which allowed high-cost production behind trade barriers. With those barriers gone or reduced, the potential for competition from abroad is forcing the pace of deregulation and the modernization of corporate operations.

Although policy continuity is not assured, it is my judgment that the administration of President Carlos Salinas intends to persevere in the modernization of the Mexican economy and will complement its internal program with constructive negotiations on trade, debt, and investment.

Mexico's trade liberalization has been accompanied by a growing business and government constituency for the country's outward orientation. This is in sharp contrast to the late 1970s when the Mexican government's tentative move toward the GATT lacked domestic support. Rather than rely on government spending and protection without making essential reforms, the de la Madrid and Salinas administrations have introduced a series of internal and external policy changes, including the sale of a number of state enterprises, liberalization of tariff and non-tariff barriers, and the elimination or reduction of subsidies.

The country's maximum tariff is now 20 per cent and, on a trade-weighted basis, about 20 per cent of imports are now subject to import licenses, historically a very low percentage for Mexico. Professor Sidney Weintraub of the University of Texas at Austin has estimated that, in 1988, the simple and trade-weighted average Mexican tariffs were around 17 and 5.6 per cent respectively. The modification of the Mexican tariff schedule in early 1989 will raise those numbers, perhaps to above ten per cent for the trade-weighted average tariff.

Perceptions in the United States have not kept pace with the changes in Mexican trade policies and performance. It is not uncommon to encounter U.S. attitudes that reflect impressions formed during the long years of Mexican reliance on a relatively closed economy. However, Mexico's development model is no longer at odds with professed U.S. support for open trade policies.

Mexico also tends to view the United States through a somewhat skeptical prism. While complaints by U.S. industries have not always led to restrictions, those barriers that the United States did impose contributed to the widespread impression in Mexico that U.S. trade barriers have been serious obstacles to an expansion of bilateral trade, and to Mexico's capacity to service its debt.

BILATERAL NEGOTIATIONS

The chain of events that led to the framework agreement was characterized by an ever-widening base of support for better bilateral trade relations. In 1981 and 1982, just as the debt crisis unfolded, some leaders from both countries began to consider ways that Mexico and the United States could move toward an agreed framework for trade and investment. They argued that mutual trade and investment flows could be much greater if the governments put in place a more certain framework for bilateral commerce. Advocates of a renewal of bilateral negotiations cited the lingering quarrel over fisheries and the acute disagreements over subsidies and countervailing duties as examples of disputes that could have been better resolved through agreed procedures, had a bilateral mechanism for dispute settlement been in place. Gradually, supporters of an agreement gained ground, as the chronology in Attachment One demonstrates, and the signature of the agreement in 1987 capped six years of effort.

In the agreement, the two governments established a framework for future negotiations and dispute settlement. (See Attachment Two.) The agreement begins with a statement of principles that emphasizes the importance to both countries of an "open and predictable environment for international trade and investment". The principles fall into three categories: general economic and political goals; recognition of the key circumstances that affect the bilateral relationship —for example, shared GATT membership and Mexico's status as a developing country; and principles on key issues, namely, services, intellectual property protection, border development, and private investment.[2]

Next, the agreement sets out the procedures for consultation and dispute settlement, including a timetable for the bilateral resolution of problems and an agreement to seek other means of settlement, in particular, referral of disputes to the GATT. Either country may seek consultations at any time on bilateral trade and investment matters. Both countries committed themselves to improve the exchange of statistical information and to participate in the GATT's work on tariffs.

Finally, in an "Immediate Action Agenda", the two countries agreed to consult, within 90 days of the agreement's signature, on textile products, agricultural products, steel products, investment matters, matters involving technology transfer and intellectual property, electronics products, and the service sector in the context of the Uruguay Round. In fact, some significant follow-up agreements were reached as a result of that 90-day timetable for action. U.S. and Mexican negotiators made progress on steel, including a cross-sectoral bargain that liberalized the Mexican market in other areas in exchange for improved U.S. quotas on steel products; textiles and apparel; and the liberalization of many Mexican trade barriers.

Apparently modest in scope and objectives, the Mexico-U.S. bilateral accord seems less so when one considers the difficult path the negotiators had to walk to reach it. The time it took to negotiate the framework agreement, even allowing for the delays caused by the attention given to Mexico's international debts, provided ample evidence of the effects of many years of divergent policies and inadequate mechanisms for bilateral consultation and dispute settlement. Against a background of suspicion and misunderstandings and quite different economic philosophies, the achievement of the bilateral accord was very significant.

The willingness of Mexican government and business leaders to discuss foreign investment was a significant step toward an internationally oriented economy, although the agreement does not spell out in detail the scope of discussions of investment issues. For the United States, recognition of the importance of Mexico to its own interests is a great improvement over the sporadic attention previously given to bilateral trade and investment.

This is not to say that bilateral trade and investment disputes are a thing of the past. As with any two countries with substantial trade and investment relations, there will always be policy differences between Mexico and the United States of varying duration, importance, and intensity.

OPTIONS FOR BILATERAL NEGOTIATIONS

The U.S.-Mexican framework agreement is a starting point from which to seek specific trade and investment goals. For example, immediately following the signature of the agreement U.S. government officials indicated that they would consider adding auto parts and pharmaceuticals to the list of sectors for priority discussion.[3] In August, 1988, representatives of the two countries established an agenda for future trade and investment talks, including sectoral negotiations. Currently, there is considerable Mexican interest in bilateral trade negotiations with the United States. A positive U.S. response would allow the two countries to build on the framework agreement. Such U.S. action would also respond to Section 2101 of The Omnibus Trade and Competitiveness Act of 1988, which recognized the importance of the framework agreement and encouraged additional negotiations.

Using the framework agreement. Making effective use of the framework agreement is therefore an important option for bilateral trade and investment cooperation. Improving the agreement's provisions on consultation, notification, and dispute settlement would be one means of enhancing it. There may also be further negotiations on issues related primarily to U.S.-Mexican relations (e.g., border development and assembly industries) which evolve from the experience gained under the bilateral agreement. The two nations could also use the framework agreement for bilateral consultations on their respective approaches to negotiations on services in the Uruguay Round.

U.S. tariff preferences for Mexico. A unilateral U.S. expansion of the preferential tariff treatment for Mexico is an option that appeals to some Mexican leaders because such a move would recognize Mexico's already substantial trade liberalization. However, U.S. authorities have sought to link duty-free treatment to specific actions by beneficiary countries, for example, to protect intellectual property; they have also reduced the benefits of the Generalized System of Preferences (GSP) on a product or country basis. The expansion of Mexico's duty-free access to the U.S. market would be difficult for the United States if it were not accompanied by tangible Mexican commitments. Although the U.S. GSP is often seen in Mexico as a bellwether of U.S. intentions toward Mexican exports, in fact its significance to bilateral trade has become quite limited. An attempt to expand its application to Mexican exports would meet significant resistance from a variety of U.S. interests and the eventual results of the effort might be small.

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[2] Mario Rodriquez-Montero, Mexican Trade Office, Washington, D.C., "Mexican-United States Bilateral Framework of Principles and Procedures for Consultations regarding Trade and Investment Relations" (typescript), November 1987.

[3] Inside U.S. Trade, Vol. 5, No. 46, Washington, D.C. November 13, 1987.

Sectoral negotiations. In 1989, Mexican and U.S. trade officials may initiate discussions of possible sectoral agreements with the United States. Examples of possible subjects of those talks are the automotive, electronics, and petrochemicals sectors; agriculture; and functional issues, such as services (including travel and tourism), investment, and "contingent" protection against the use of antidumping and countervailing duties, escape clauses, and responses to unfair trade practices.

Sectoral negotiations face several hurdles. The historical experience is not encouraging, as the Canadian attempts to achieve sectoral accords with the United States demonstrate. The bilateral exchange of discriminatory concessions in specific sectors would probably require a waiver of the Most-Favored-Nation requirements of the GATT. And, it would be difficult for the United States and Mexico to reach balanced and reciprocal agreements on a sectoral basis because the exchange of concessions would tend to fall in sensitive industries.

A comprehensive trade and investment agreement. The Mexican interest in the sectoral approach to bilateral negotiations stems in good part from concern over the disparate economic strength of the two economies. Staged, asymmetrical concessions within a comprehensive mutual commitment to bilateral liberalization offer an alternative to the sectoral approach. Spanish accession to the European Community provides examples of an exchange of staged concessions between unequal partners.

An illustration of the manner in which a comprehensive negotiation could meet the concerns of both countries is found in the following outline of a broad agreement, which is under consideration with the Mexico-U.S. Business Committee:

—In the first phase of the agreement, the United States could lower and eliminate barriers to Mexican products according to a considerably shorter timetable than that applied by Mexico to U.S. products.

—Mexico's first phase commitments could include the maintenance of its current liberal trade policy; the liberalization of foreign investment laws and programs; and improvements in the protection of intellectual property to bring Mexican practices into line with world standards.

—Duties on some products could be eliminated immediately. For example, the United States might lower to zero U.S. duties on Mexican products where the existing tariff was under ten per cent.

—All other barriers would be phased out over varying periods, depending on the country, the product, and the industry.

—The two countries would carefully design programs for the gradual elimination of barriers in key sectors, within their overall commitment to trade and investment liberalization.

—The agreement could establish improved trade and investment dispute settlement mechanisms, agreements on safeguards, antidumping, and countervailing duty laws.

The negotiation of the staged implementation of a comprehensive U.S.-Mexican trade and investment agreement could allow adequate time for the full liberalization of barriers in import sensitive industrial and agricultural areas and thus reflect the competitive concerns of each country. Such a staged process would be comparable to a sectoral approach but would offer some significant benefits over the latter. The two countries would benefit from greater market access in many areas that sectoral negotiations would not encompass. Another key difference is the GATT-consistency of the comprehensive approach, if the United States and Mexico placed their actions within an agreed plan and schedule for the removal of barriers on "substantially all" bilateral trade.

Of course, the process could be halted at any time, if either country's liberalization failed to meet the jointly agreed objectives.

Some argue that a comprehensive bilateral agreement between the United States and Mexico would be extremely difficult to negotiate. They cite the entrenched resistance in the United States to reduction of certain long-standing barriers to industrial and agricultural trade as well as the disparate levels of development of the two countries. My response is that the high economic stakes for both nations justify serious efforts to develop a binational consensus in favor of comprehensive negotiations.

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ATTACHMENT ONE

U.S. COUNCIL OF THE
MEXICO-U.S. BUSINESS COMMITTEE

SPONSORS: COUNCIL OF THE AMERICAS • CHAMBER OF COMMERCE OF THE UNITED STATES • AMERICAN CHAMBER OF COMMERCE OF MEXICO, A.C.

Key Events during the Negotiation of the U.S.-Mexico Bilateral Agreement on Trade and Investment

1981 **June**

In the aftermath of President Lopez Portillo's 1980 decision not to join the General Agreement on Tariffs and Trade (GATT), Presidents Reagan and Lopez Portillo establish the U.S.-Mexico Joint Commission on Commerce and Trade for government-to-government consultations.

October

The 36th Plenary of the Mexico-U.S. Business Committee discusses a proposal for a bilateral framework agreement, Washington, D.C. (The bilateral framework agreement is sometimes referred to as a bilateral trade and investment agreement or a bilateral commercial agreement.)

1982 **October**

The binational Business Committee considers a report on bilateral trade and the outline of a possible framework agreement at its 37th Plenary, Ixtapa, Guerrero, Mexico.

November

U.S. and Mexican negotiators are unable to find a means to resolve bilateral trade disputes involving Mexican subsidies and U.S. countervailing duties.

1983 **October**

The Mexico-U.S. Business Committee presents its proposals for a bilateral agreement, Houston, Texas.

1984 Continuing a trend begun in 1982, U.S. firms file complaints about Mexican export subsidies. (From 1980 to 1987, U.S. interests filed twenty-seven complaints; countervailing duty orders are in effect for thirteen.)

October

The Mexican Business Council for International Affairs (CEMAI) agrees to support the concept of a bilateral framework agreement between the United States and Mexico. (The CEMAI is the sponsor of the Mexican Section of the binational Mexico-U.S. Business Committee.)

1984 **November**

The Chamber of Commerce of the United States announces its support for the concept of a bilateral commercial agreement between the United States and Mexico.

December

Mexican and U.S. officials discuss a draft Statement of Intent to negotiate a framework of principles and procedures on trade and investment.

1985 **February**

In a meeting in Mexico City with members of the Mexico-U.S. Business Committee, President de la Madrid states that Mexico will: (1) attempt to resolve outstanding trade and investment issues with the United States, including disputes on export subsidies and U.S. countervailing duties and Mexican regulation of the chemical-pharmaceutical industry; (2) restructure the Mexican economy and its trade regime; (3) consider a bilateral commercial agreement with the United States; and (4) review Mexico's multilateral commercial relations, that is, its possible membership in the GATT.

April

The Mexican government announces its Program for the Development of Exports (PROFIEX), which confirms its willingness to consider a bilateral agreement with the United States.

Mexican Secretary of Commerce and Industrial Development Hector Hernandez Cervantes and U.S.T.R. William E. Brock III sign an agreement that provides Mexican exporters with the injury test in U.S. countervailing duty investigations in exchange for a Mexican commitment to eliminate export subsidies;

Brock and Hernandez also announce an agreement on the Statement of Intent to negotiate a framework of principles and procedures on trade and investment, which would cover tariffs and non-tariff barriers, investment, administrative actions, and the establishment of regular consultations.

The American Chamber of Commerce of Mexico, testifying in Washington before the International Trade Subcommittee of the House Committee on Ways and Means, announces its support for the bilateral framework agreement.

July

Mexico introduces sweeping reforms in its trade regime, including tariff cuts, reduced use of import licenses, and the phased elimination of official import prices.

Mexico and the United States, at their fifth Binational Meeting, reiterate their willingness to negotiate a bilateral trade and investment agreement.

1985 **September**

The U.S. Trade Policy Staff Committee requests public comments on the discussion of a trade and investment agreement with Mexico.

The U.S. Council of the Mexico-U.S. Business Committee and the Council of the Americas communicate their support for the bilateral agreement to the U.S. government.

October

The Mexico-U.S. Business Committee reiterates its strong support for a bilateral commercial accord.

November

Mexico announces its intention to join the GATT and opens negotiations with the GATT Contracting Parties.

December

U.S. and Mexican officials meet in Washington for discussions on the framework agreement.

1986 **April**

Mexico and the United States agree to defer negotiation of the bilateral agreement until Mexico completes GATT accession.

July

In the context of the GATT talks, Mexico lowers tariffs or eases licensing requirements for 210 manufactured products, chemicals, and agricultural commodities of particular interest to the United States.

The GATT Contracting Parties approve the terms of Mexico's accession to the GATT.

August

Presidents Reagan and de la Madrid instruct their trade negotiators to complete the bilateral framework agreement in 1987.

Mexico formally accedes to the GATT.

1986 **October - December**

Mexico and the United States attempt to resolve issues stemming from Mexican laws on the protection of intellectual property. Mexico passes legislation that improves the protection of intellectual property, but denies for ten years access to product patent protection to companies in the pharmaceutical, agrichemical, and biotechnology sectors.

1987 **January**

Partially in response to the Mexican treatment of intellectual property, the United States declares that an estimated $637.5 million of Mexican exports (based on 1986 trade) will not be eligible for duty-free treatment under the U.S. Generalized System of Preferences.

February

Mexico and the United States recommence negotiations on a bilateral agreement.

May

U.S. and Mexican negotiators meet in Ixtapa for a formal negotiating session on the bilateral agreement.

August

U.S. and Mexican officials meet in Washington to prepare a single negotiating text of the bilateral agreement.

September - October

U.S. and Mexican negotiators prepare the final text of the bilateral framework agreement.

November 6

Secretary of Commerce and Industrial Development Hector Hernandez Cervantes and U.S.T.R. Clayton Yeutter sign the bilateral agreement on behalf of Mexico and the United States.

ATTACHMENT TWO

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

UNDERSTANDING

Between the Government of the United States of America and the Government of the United Mexican States Concerning a Framework of Principles and Procedures for Consultations Regarding Trade and Investment Relations

I. STATEMENT OF PRINCIPLES

The Government of the United States of America and the Government of the United Mexican States:

1. Desiring to enhance even further the friendship and spirit of cooperation between both countries;

2. Recognizing that continuing dialogue and frequent consultations concerning trade and investment matters are vital to the constructive and positive relationship between the United Mexican States and the United States of America;

3. Recognizing the desirability of resolving all issues as soon as possible;

4. Taking into account the participation of both countries in the General Agreement on Tariffs and Trade, and noting that each party reserves for itself the rights it may have under the terms of the General Agreement, together with its agreements, understandings, and other instruments;

5. Recognizing Mexico's present status as a developing country and the rights and obligations accorded to developing countries under the General Agreement on Tariffs and Trade and all other instruments applied therefrom;

6. Recognizing the importance of promoting a more open and predictable environment for international trade and investment;

7. Taking into account the need to eliminate non-tariff barriers in order to facilitate greater access to the markets of both countries;

8. Recognizing that export earnings are important to the ability to fulfill foreign debt obligations;

9. Recognizing the benefits that can result for each country from increased international trade, as well as the detrimental effects of protectionism;

10. Recognizing the increased role of services in their domestic economies and their bilateral relations, and taking into account the commitments undertaken by both countries in the Uruguay Round;

11. Recognizing the complementary role of direct foreign investment in furthering growth, creation of jobs, expansion of trade, technology transfer and economic development;

12. Recognizing the importance of providing within the legal and regulatory framework of each country adequate protection and enforcement of intellectual property rights; and taking account of their commitments in GATT, in the conventions administered by the World Intellectual Property Organization (WIPO), and in the Universal Copyright Convention;

13. Recognizing the special role of commerce in the development of their border regions and the need for special cooperation on border commercial matters;

14. Taking note of the progress made in the current process of trade liberalization of the Mexican economy;

Intend to abide by the preceding principles of trade and investment and agree to the following:

II. Consultative Mechanism

1. Either party may request at any time consultations with the other party on any matter concerning bilateral trade and investment relations, including trade and investment opportunities and problems. Any such consultations shall be without prejudice to the requirements of domestic law.

2. Requests for consultations shall be accompanied by a written explanation of the subject to be discussed and consultations shall be held within 30 days of the request, unless the requesting party agrees to a later date. Consultations will take place initially in the country whose measure or practice is the subject of discussion.

3. In the event that consultations involve a dispute concerning a trade measure or practice, every effort will be made to resolve the dispute at the working level. Either party may request review of the issue at a higher level. If resolution is not reached within 30 days following the first meeting, either party may seek other means of settlement, including referral of the dispute to the dispute resolution procedures applicable to the General Agreement on Tariffs and Trade (GATT), to which both countries are a party. If a measure is referred to the GATT, consultations under this Understanding shall be considered to have constituted consultations under Article XXIII(1) of the GATT or any preliminary bilateral consultations required as part of any GATT code dispute settlement procedures.

4. In the event that consultations involve an investment measure or practice, every effort will be made to resolve the issue at the working level. Either party may request review of the issue at a higher level. If agreement is not reached within 30 days following the first meeting, either party may use other means consistent with its domestic law and international obligations.

5. Consultations should be held annually at the Cabinet or Subcabinet level to review the status of the bilateral trade and investment relationship.

6. All consultations under this Understanding will be jointly headed by the Office of the United States Trade Representative (USTR) on the part of the United States and by the Secretariat of Commerce and Industrial Development (SECOFI) on the part of Mexico. SECOFI and USTR shall be assisted by officials of other governmental entities as circumstances require and may delegate their authority when appropriate.

III. Data Exchange

1. Both parties will examine the requirements and possibilities which arise concerning an improved exchange of statistical information. In addition, both parties will participate in the GATT Tariff Study.

Done in Mexico City this sixth day of November, nineteen hundred eighty seven, in four original copies in the English and Spanish languages, each text being equally authentic.

By ______________________ By ______________________

for the United States of America — for the United Mexican States

IMMEDIATE ACTION AGENDA

In relation to the Understanding Between the Government of the United States of America and the Government of the United Mexican States Concerning a Framework of Principles and Procedures for Consultations Regarding Trade and Investment Relations, the United States and Mexico confirm the following:

1. To be ready to commence the holding of bilateral consultations, within 90 days of the signing of the aforementioned Understanding, on the following topics:

- textile products
- agricultural products
- steel products
- investment matters
- matters involving technology transfer and intellectual property
- electronics products
- exchange of information on the service sector geared towards improved analysis and towards the work being undertaken in the Uruguay Round of Multilateral Trade Negotiations.

2. Both parties recognize that the inclusion of the preceding topics in the immediate Agenda of Consultation does not limit the right of each country to include any other issue relating to trade and investment which might arise in the short term and require immediate bilateral consultations; neither does it prejudice the raising of new issues in the future.

Done in Mexico City this sixth day of November, nineteen hundred eighty seven, in four original copies in the English and Spanish languages, each text being equally authentic.

By ______________________ By ______________________

for the United States of America — for the United Mexican States

PREPARED STATEMENT OF ROBERT J. MORRIS

I welcome the opportunity you have offered me, Mr. Chairman, to comment on certain features of a viable American trade strategy for the years ahead, and in particular to elaborate on the views which I expressed in an article published last summer in the Brookings Review.

I wish to emphasize at the beginning that my appearance today is in my personal capacity and that my views, do not necessarily represent those of the U.S. Council for International Business. However, I want to underscore the U.S. Council's major goal of on open, strong and effective multilateral trade, investment and financial system, and its stress on the importance of the stake which the U.S. in general and American business in particular has in the successful conclusion of the Uruguay Round of GATT negotiations. An open multilateral trade system is vital to the interests of the United States, and its enhancement should remain the top trade policy priority of the government, both now and in the future.

Turning now to my personal comments, in the Brookings article, a copy of which is attached to this statement, I laid out a three-track approach to an American trade policy strategy for the 1990's. The first track is the vigorous prosecution to as successful a conclusion as possible of the Uruguay Round of GATT negotiations. The second recommends negotiations involving only those countries prepared to contemplate substantial new liberalization and arrangements to cover new areas affecting trade and investment going beyond agreements which could be negotiated now in GATT. The third recommends bilateral negotiations to deal with specific trade problems, whether of the kind contemplated under Section 301 of U.S. trade law or as might be needed to protect or promote American interests in particular situations. I have in mind, for example, the case of the U.S.-Mexico Framework Agreement; issues not fully covered in the U.S.-Canada Free Trade Agreement; or those which are emerging as the European Community moves to implement its single market program.

I would like to focus my comments today on the second of these three approaches. My intention was to identify a market-opening alternative to the more widely-discussed options of multilateral negotiations through the GATT, or bilateral, through separate comprehensive free trade area agreements with a variety of different countries. In my view, these two options are neither mutually exclusive (as they are often presented) nor do they encompass the full universe of possibilities.

I start from the premise that the interests of the United States require us to reverse the trend toward growing sectoral protectionism of the decade since the conclusion of the Tokyo Round of GATT negotiations, and to reestablish the momentum toward market-opening trade liberalization which is the best guarantee we have of both national and global prosperity. My main concern was to suggest an option to do that which involved less than full GATT participation or less comprehensive coverage than would be required in a GATT-consistent free trade area. I believe that we can accomplish a great deal to reform and strengthen the GATT system in the current negotiations. However, I also believe that we must take other steps, both to make that expectation a reality and to capitalize on the 0pportunities it will create. Finally, I am doubtful that the conclusion of GATT-consistent free trade areas with very many other countries is either likely or perhaps even desirable. A balanced strategy needs more options.

The concept of sectoral free trade with selected partners discussed in my Brookings article is one such approach. It would involve negotiation of liberalization "packages" among the participants for each category of products or services to be covered by the arrangement. Among other elements, such packages could include reduction or elimination of tariffs and other direct restrictions on imports; commitments regarding protection of intellectual property rights, freedom of establishment, and other investment-related measures; removal of domestic practices (such as subsidies) which could distort trade and competitive conditions and other measures. Where required by GATT rules (such as in the removal of tariffs or quotas) application should be on an MFN basis; but in all other aspects, the obligation need only extend as regards other participants.

There are other possibilities under the "plurilateral" track. I would like to concentrate the rest of my remarks on one which would build on the growing recognition of the importance of the Pacific Basin countries to American interests, both economic and political, and the importance of defining a more constructive and comprehensive framework for conducting our economic relations with those countries in general and Japan in particular.

The model for one such alternative approach lies in the U.S.-Mexico Framework Agreement of 1987, but extended to organize our commercial relations and promote further market-open agreements with several countries simultaneouly. Under that model, the agreement would be limited to establishment of a framework arrangement, initially with a core group of Pacific Basin countries, but expandable later to include others. The purpose of the agreement would be twofold:

—To establish principles and procedures which would supplement commitments of the participants in the GATT as regards trade and investment relations among them.

—To create a consultative or negotiating mechanism which can be used to clarify respective policies, resolve specific disputes, initiate cooperative projects for the development of trade and investment opportunities within the region and, specifically, to negotiate the reduction or removal of trade or investment barriers.

A variety of proposals have surfaced concerning the candidates for such a scheme. My own view is that we should concentrate first on those Pacific Basin economies with relatively high per capita incomes, ranging from the U.S., Japan and Canada through Australia, New Zealand and the so-called four tigers: Korea, Taiwan, Singapore and Hong Kong. These are the countries whose markets are most capable of rapid expansion under open trade conditions and whose enterprises and people are likely to be both our toughest competitors and best customers.

Under the arrangement, each participant could identify those priority sectors or problem areas on which it wishes the negotiating process to focus. Negotiating groups would be created to work out market-opening solutions to the problems identified, stressing the need for the removal of competition-distorting practices in the process. If deemed appropriate, it could eventually be grafted onto a more comprehensive institutional structure—a sort of OECD for the Pacific, as George Shultz and former prime Minister Nakasone have suggested—which could also serve as a forum for consultation about broader economic policies, development strategies, financial relations, etc.

Rather than replace the GATT as the preferred forum for dispute settlement, the arrangement could offer a supplemental mechanism providing an effective process for settling disputes based on the higher performance criteria embodied in the agreements. Both the U.S. Mexico and U.S.-Canada agreements offer possible models.

The participants should agree at the outset that one of the main objectives of the agreement would be to implement arrangements governing trade in services, investment and protection of intellectual property rights, at least as regards their relations with each other. If the Uruguay Round does not produce fully adequate global agreements on these issues, the participants would negotiate new or supplementary arrangements among themselves. As regards trade in services, for example, deregulation of civil aviation and the opening up of fair competition in shipping services might be areas lending themselves to special regional treatment in this context.

Other examples of issues upon which closer regional consultation and perhaps joint action might be undertaken could include the process of setting standards and extending the coverage of facilities for testing and certification of products to meet those standards. Another area for attention might be liberalization of government purchasing practices beyond that which might be negotiable multilaterally in GATT. Also, as suggested in my article, the scope for opening up access to the research, development and other industry promotion programs of the governments involved to the enterprises of other participants should be explored.

In any agreement which might be concluded concerning whole sectors, a critical component would have to be the elimination (at least as regards trade among participants) of special government assistance to such sectors or other practices which distort competition. carefully crafted arrangements directed toward such problems could go far in making trade fair as well as free. Here especially, the institutional framework would provide a mechanism under which disputes about implementation could be quickly addressed and resolved.

As regards reduction or elimination of tariffs, my recommendation would be to take such action mainly in categories where countries of the region account for a large portion of world trade. As with the option I discussed earlier, any action on tariffs or other direct controls on imports should be extended on an MFN basis, but much of the rest of what I have outlined as the activities under the arrangement need only be extended to other participants. I do not believe that the "free rider" problem need concern us overly much; studies of regional trade patterns show pretty conclusively that the main beneficiaries of liberalization by Pacific region countries would be other countries in the region, including the U.S. However, the perception of the problem is important, and we need to preserve some bargaining leverage to open other markets outside the area.

A commitment to use the mechanism of the arrangement as the process of choice in the settlement of disputes among the parties would be a powerful inducement for others to cooperate with us. Such a commitment would be a pledge that no participant—including the United States—would act unilaterally against any other in areas covered by the agreements concluded. Though we would have to retain our freedom to act pursuant to U.S. law where required, we should also be willing to use the dispute settlement process of the arrangement before taking such action in all but the clearest emergency situations. As with the U.S.-Canada agreement, our willingness to give such a commitment may be the most important bargaining chip we have, but we must be willing to use it if we want to get real results.

Let me now move to questions of how and when.

No trade strategy for the United States will succeed if it ignores two fundamental realities of the next few years. The first is the global commitment to conclude the Uruguay Round by the end of 1990. The United States has too much at stake in the maintenance of a viable multilateral system and the need for improvements in it to permit any other initiative or preoccupation to destroy the opportunity for real progress in the Round. However, the initiatives I have suggested can help stimulate those negotiations to higher levels of achievement, and in the longer run can help strengthen the GATT itself by providing a forceful example of what real market opening can accomplish for an even wider circle of participants.

The second reality is the set of new requirements in the 1988 Trade Act for the Administration to be much more aggressive in bilateral negotiations to deal with unfair practices and remove barriers to American exports. The U.S. cannot devise strategies for dealing with Japan or any other country in a vacuum which denies these imperatives or pretends that action on them can be compartmentalized in ways that have no effect on other initiatives. Thus, the government—both Congress and the Executive—must work out a strategic plan which permits an optimum outcome on each separate front.

There are several conceivable ways of meeting the new trade act requirements, especially those mandated in Section 310, the so-called Super 301. The Administration could decide not to identify Japan and some of the other East Asian countries as "priority countries" under the section, while it moves to consolidate a new relationship with them over the next year or so. Alternatively, it could focus on various "priority practices", identifying only those countries as priority in which such practices are especially egregious. These may or may not include Japan and the others, but in any case could be deemed less "offensive" than the priority country approach.

I leave it to you to decide how such interpretations would fly with Congress. However, if it is ultimately decided that some East Asian countries ought to be designated as priority under Section 310, why not try to make—a virtue of necessity? Instead of apologizing for such a process, or getting excessively self-righteous and belligerent about it, why not stress that designation is an invitation to join with the U.S. in creating a new relationship—a mutually advantageous relationship of mature allies rather than a mutually recriminating relationship of bickering adversaries?

The more constructive alternative is one which offers the real prospect of putting our grievances behind us as a source of constant irritation and stalemate in favor of real trade liberalizing action across a broad front and involving several key countries in the Pacific region. It is designed to build from foundations laid in the GATT negotiations, not compete with or detract from them. It is a relationship from which all stand to gain and therefore to which all are more likely to contribute willingly rather than one that results in grudging acquiescence to unilateral demands, and which only stimulates the search for ways to get around the commitments made.

However, it is also an invitation which is not open-ended in time. Section 310 imposes certain deadlines and other constraints which preclude a leisurely or complacent approach. These cannot be ignored—they are, after all, the law. But I would hope that the Congress and the Administration could work out understandings on implementation which would provide the flexibility that may be required if real progress toward the arrangement I have recommended justified it.

Thank you.

COMMUNICATIONS

Trading Bloc Heads

By Joseph A. Greenwald

The big hype job of 1989: Regional blocs will take over the world. There's a lot more smoke than fire here

Despite the launching of the most ambitious round of multilateral trade negotiations since the General Agreement on Tariffs and Trade in 1947, increasing attention has been paid in the '80s to bilateral and regional arrangements. Looking to the post-Reagan era in an article in the January/February issue of *The International Economy*, George P. Shultz listed as the first challenge "regional economic cooperation and prosperity."

Is the post-World War II multilateral trading system coming to an end? Will the world break up into a handful of regional trading blocs?

The main events giving rise to these questions are Europe's 1992 single-market program and the successful conclusion of the U.S./Canada free-trade agreement, which has a 10-year implementation period.

To understand the significance of this development, it is necessary to get behind the rhetoric and analyze the various forms of economic integration and cooperation, both bilateral and regional. Geography, politics, economic structures and policies must also be considered.

Secretary Shultz writes that "global trends are leading national governments to tackle issues that cannot be managed within a single nation state or national economy." In his view, "Regional initiatives are playing an ever more important role in promoting freer trade, closer economic cooperation and stronger growth."

On the other hand, it might be argued that, with the internationalization of production and financial flows, *global* trade and investment arrangements and policies are more logical and viable than regional blocs. In any event, much depends on the matters being dealt with: Some may lend themselves to bilateral or regional solutions; others may call for global answers.

Disappointment about slow progress in the Uruguay Round and the apparent deadlock at the December midterm review in Montreal have fueled the search for alternatives to the GATT. The standoff between the U.S. and the EC on agriculture got all the media coverage, and little attention was paid to the progress on 11 of the 15 items. Most notable was agreement on a set of principles—like national treatment and non-discrimination, a key objective for the U.S.—that will provide the framework for specific service sector deals.

Even on agriculture, the immediate problem of finding words to bridge the gap between "elimination" of trade-distorting subsidies and protection (the U.S. position) and "reduction" (the EC position) is not very difficult. It is the kind of problem negotiators deal with all the time, and they can certainly find a solution by April. The serious negotiating problems are finding a common measure for subsidies and protection, defining what form the mutual concessions must take, and measuring the value of the concessions in terms of their impact on trade.

The other key item for the U.S. is intellectual property rights. The failure to reach agreement at Montreal is more significant. From the outset of the Uruguay Round, several developing countries, led by India and Brazil, have resisted a GATT code that would include norms of standards going beyond existing international agreements on patents, trademarks and copyrights. On the other aspect of the problem—effective enforcement of existing rules—substantial agreement has been reached.

This brief rundown of the state of play in the multilateral negotiations offers ample evidence that it is premature to dismiss the GATT in favor of bilateral or regional arrangements.

Today's versions of bilateral agreements and regional compacts are a diverse lot. They range from customs unions or free-trade areas (the European Community and the U.S.-Canada FTA) that involve the reduction and removal of tariffs and other trade barriers, to Secretary Shultz' suggestion for a Pacific Basin Forum "where representatives from like-minded economies could compare experiences, discuss ideas and prepare

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Scott Newirth, *Crisis*, 1987
Private collection, New York

analyses on subjects of mutual interest."

The European Economic Community is the most advanced model of regionalism. The substance of the Community's 1992 single-market program deals mainly with measures other than tariffs, which were removed by mid-1968. However, there remained visible, physical border controls on the movement of goods and people, capital movements were not freed, the right of establishment did not exist and trade in services was not free. The goal is to add these freedoms to the elimination of duties in the customs union and to have a true-single market.

Caribbean nations have been involved with a Caribbean common market (CARICOM) and the Caribbean Basin Initiative (CBI). The CBI is mainly a one-way preferential tariff arrangement by the U.S. for goods from the Caribbean and Central America. CARICOM is a nascent common market in the Caribbean. A similar dormant deal is called CACM—the Central American Common Market.

These models are based on the theory that the economic growth of developing countries can be promoted by freer trade among them. A number of similar pacts have been negotiated in Latin America, but not many tariffs or other barriers to trade have been reduced, and such integration efforts have not been successful. Why? Nationalism is one factor. Secondly, most developing countries are reluctant to give up high tariffs and import quotas applied for infant industry or balance-of-payments reasons. Import substitution has been their policy for a long time. Third, markets are richer and easier to penetrate in the industrial North.

A somewhat different approach was taken in ASEAN about 10 years ago, but, again, without much freeing of trade or increased economic growth as a result of the integration efforts. The basic concept was complementarity. In the automotive sector, for example, production of various components was assigned to the members, with the understanding that others would not produce the same components. There was no particular economic justification for the allocation, and agreement was difficult to reach. More recently, members have shifted to a case-by-case approach, with the initiative coming from foreign companies (for example, Mitsubishi Motor Company) and the governments then agreeing on the allocation of component production for the specific project. Economic growth in the region has been high because countries moved toward more open markets, better economic policies and more attractive foreign investment practices. And, of course, the U.S. sucked in imports.

> *The standoff at the Montreal GATT session between the U.S. and the EC on agriculture got all the media coverage, and little attention was paid to the progress on 11 of the 15 items.*

The CBI model of one-way preferential tariff treatment by industrialized countries for developing countries was first used by the EC in its relations with the former colonial territories (now called the Lome Convention). In the 1960s, this kind of North-South special relationship was suggested for the U.S. with Latin America and for Japan with Southeast Asia. To head off a division of the world along North-South lines, the Generalized System of Preferences was conceived and negotiated at the 1968 UN Conference on Trade and Development.

As mentioned above, suggestions have been made for regional arrangements that are basically discussion, exchange-of-experience, and research bodies. In early February of this year, Australian Prime Minister Hawke proposed during visits to Korea and Thailand the formation of an Asian-Pacific organization similar to the OECD. The Organization for Economic Cooperation and Development is the earlier version of this model. A rich country club that was expanded to include the U.S. and Japan after Europe's postwar recovery, it is a mixture of a caucus to exchange views on positions to be taken in other international forums, macro-economic consultation and coordination (the forerunner of the G-7), informal discussion of common trade and industrial issues (e.g., agreement on the "polluter pays" principle), and binding commitments (a code for the liberalization of invisible transactions—the predecessor of the GATT services initiative).

Another version of the model is the UN regional commissions—the Economic Commission for Europe (with both Eastern and Western participation), the Economic Commission for Africa, the Economic Commission for the Far East and Asia. Although these bodies have done some concrete work, they are mainly speech-making societies (at the annual meetings) and research organizations.

The Soviet bloc has its own special model in the Council for Mutual Economic Assistance (CMEA). It is not clear how such a regional body of centrally planned, state-trading economies operates, but complaints occasionally get out about exploitation by the U.S.S.R.

The most comprehensive and significant example of a bilateral agreement is the U.S./Canada free-trade agreement. It not only removes all tariffs and some other barriers on goods moving between the parties, but also deals with such subjects as services, intellectual property rights and investment. An innovative feature is the dispute-settlement process, which sets up binational panels to hear appeals from findings in anti-dumping and countervailing-duty cases. The Canadians sought exemption from U.S. unfair trade laws (which they called "contingent protection"), but had to settle for a formula under which binational panels review the application of the respective national laws. The other U.S. free-trade-area agreement is the less ambitious one with Israel, concluded mainly for political reasons.

A framework agreement containing no concrete trade concessions was signed by the Presidents of the U.S. and Mexico in 1987. This agreement included some general principles and consultative provisions, along with a list of specific sectors for immediate bilateral consideration. Mexico had recently joined the GATT and undertook substantial liberalizing concessions in connection with its accession.

There have been, over the years, a number of customs unions or free trade areas like Australia and New Zealand, but they have been of little trade or economic significance. And the Western European countries have traditionally carried on their trade relations with Eastern Europe through bilateral agreements that list categories and quantities of goods to be exchanged.

Before World War II, the U.S. had a network of bilateral trade agreements and treaties of friendship, commerce and navigation that covered basic principles, such as national treatment. More recently, the U.S. began to negotiate bilateral investment treaties with developing countries, similar to the agreements European countries have made. The U.S. also has bilateral tax treaties.

With the internationalization of production and financial flows, global trade and investment arrangements and policies are more logical and viable than regional blocs.

In principle, there is no conflict between bilateral or regional agreements and the GATT, if certain conditions are met. The GATT permits customs union and free-trade areas as a departure from non-discriminatory or most-favored-nation treatment. The main conditions are that tariffs and other trade barriers should be removed on substantially all the trade between the parties and that barriers against outsiders should not be increased.

There have been disputes about whether these conditions have been met in some instances, particularly over the EC's exclusion of agriculture and the level of its common external tariff. And the drafters of the GATT probably did not anticipate the customs union exception being used for such an extensive and important grouping as the EC. But the GATT has not formally found against any of the agreements.

Some countries, e.g., Mexico, Brazil and Argentina, raised questions about the U.S. negotiating a comprehensive agreement with Canada while the Uruguay Round is underway. The U.S. response has been that the U.S.-Canada agreement could show the way to dealing with the "new" items in the multilateral negotiations. In the event, useful progress was made only on services.

U.S. policymakers such as James A. Baker III, Clayton Yeutter and George Shultz also viewed the bilateral approach as a spur to other countries to participate actively in the GATT round. Dating back to an unsuccessful ministerial meeting in Geneva in 1982, the U.S. has been trying to get other GATT members to agree to a broad negotiation based on the U.S. agenda. This objective was finally achieved at Punta del Esta in 1986. But the bilateral option is still considered by U.S. policymakers as an alternative, should the multilateral talks fail.

With all the rhetoric from the U.S. about the bilateral/regional alternative to the multilateral approach and the expressions of concern and interest from other countries, what is likely to happen?

Assuming no major policy shift in the Bush administration and no change in external circumstances, the most likely scenario is concentration on the multilateral approach through the GATT negotiations for the next two years. Bilateral discussions may take place, particularly with Mexico, but no concrete negotiations for free-trade areas or regional arrangements are likely to be on the agenda.

The U.S. Congress has put authority for such negotiations in the 1988 trade legislation and reports have been requested from the International Trade Commission on possible free-trade agreements with Japan and Korea. But there are widely differing views about the content of such agreements, and it appears that free-trade-area agreements (in the GATT sense) with Japan and Korea or other Asian countries are non-starters.

There are several reasons for this conclusion. First, experience with trying to open these markets to U.S. trade and investment has generally been frustrating and unrewarding. Not only are there persistent and effective non-tariff barriers, but "systemic" problems are almost impossible to deal with. These are cultural differences, closed societies and insular ways of thinking and acting, as well as business-government relations that lead to hidden subsidies and administrative guidance. It would be difficult to achieve true reciprocity.

Second, the U.S. is not, at the moment at least, competitive with these countries in a number of areas. Finally, there would be real political problems in selecting one or two countries in the area for free-trade agreements and leaving others out. One of the proponents of a free-trade area with Japan, former Ambassador Mike Mansfield, answered this criticism by saying that the other countries could join if they wanted to. This solution would make the concept less attractive to those who are seeking an answer to the problem of continuing U.S.-Japanese trade frictions.

A possible alternative for Japan and Korea might be framework agreements with consultation and dispute-resolution provisions but not the elimination of tariffs and other trade barriers. Such an agreement could also deal with the "new" matters like services, intellectual property rights and investment, depending on how the GATT round comes out in these areas.

For political and security—as well as economic and geographic—reasons, Mexico is the most likely candidate for bilateral negotiations in the near future. Negotiations are continuing under the 1987 Framework Agreement on Trade and Investment. Presidents Reagan and Bush have talked about an agreement with Mexico or about a North American free-trade area. President Salinas has also made noises about further negotiations.

At the moment, the Mexican side seems to be thinking in terms of free trade in selected sectors. The U.S. side has not taken a formal position, but there have been discussions between the U.S. and Mexican business communities, which have led to the idea of an asymmetrical comprehensive trade and investment agreement.

In light of the problems posed by GATT (substantially all trade must be covered) and the demonstrated difficulties of the sectoral approach in the Canadian case (Canada first proposed a sector arrangement, but it proved impossible to agree on the sectors), an alternative could be negotiation of a plan and schedule for achieving a free-trade area over a long period (say 20 or 25 years), with the disparity in levels of development taken care of by the U.S. moving earlier on the removal of tariffs and other trade barriers. If the U.S. decides to follow the bilateral route after the conclusion of the Uruguay Round, this asymmetrical formula might be the model for agreements with developing countries.

The EC as a bloc is certainly here to stay. The impetus toward further integration from 1992 and the need to absorb Greece, Spain and Portugal is likely to continue for a few years. Just as U.S. companies saw the vision in the 1960s and began to organize and do business on a European basis, so European businessmen have accepted the reality of a single market and are moving from their attachment to narrower national markets.

But the history of European integration suggests that the path is not always upward. The general economic climate and external circumstances (e.g., the oil crisis) can slow the process. Political factors will also come into play as the more sensitive areas of sovereignty are touched upon (free movement of people, single currency, central bank). Further enlargement (Turkey, Norway, Austria) and developments in Eastern Europe (particularly East Germany) may divert attention from the integration objectives.

Trade relations between the U.S. and the EC generally have been carried out under the GATT rules and procedures. Except for government procurement, the 1992 single-market program deals with areas not currently covered by GATT—services, investment and intellectual property rights. To the extent that these matters are not quickly dealt with in the GATT negotiations, the U.S. will have to negotiate with the EC, either bilaterally or in another forum, such as the OECD. The basic principle of such negotiations—reciprocity—has already been the subject of trans-Atlantic rhetoric. In recent years, there has been some confusion about this time-honored concept, but it should be possible to clear it up before serious negotiations begin.

The EFTA countries have taken heart from President Delors' January 17 speech to the European Parliament to open the possibility of their getting the benefits of 1992 without joining the European Community. If the EC actually gives preferred treatment to Western (or Eastern) European non-members, there will be more potential for U.S.-EC friction.

The other bloc likely to continue for the foreseeable future is the Soviet Union and Eastern Europe. But the Gorbachev program is somewhat more problematic than the EC's 1992. Bilateral relations between the EC and Warsaw Pact countries have improved and there is some dreaming about attracting the Eastern Europeans into the EC.

In sum, except for a growing and more integrated Western Europe, it is unlikely that significant bilateral or regional trade negotiation initiatives will be undertaken before 1990. After that, much depends on the outcome of the Uruguay Round of GATT negotiations and the general climate for trade and investment.

But there are inherent difficulties and problems in the proliferation of bilateral and regional arrangements. Some of them have been described above; others were demonstrated by the pre-World-War II international economic experience that led to the move to multilateralism. The changes in transportation, communication, production and finance that have taken place in the past decade make a system of bilateral and regional arrangements with concrete commitments even less viable. The most advocates of regional or bilateral pacts can hope for are loose regional groupings (OECD model) or framework bilateral agreements like the current Mexican model. ♦